

Statement on behalf of the National Association of Home Builders

Joint Hearing on Energy Tax Policy and Tax Reform

**Committee on Ways and Means
Subcommittee on Select Revenue Measures**

September 22, 2011

On behalf of the 160,000 members of the National Association of Home Builders (NAHB), we respectfully submit this statement discussing the significance and impact of existing energy tax policies on housing and related industries. The energy efficiency of the built environment is a critical resource issue. Due to the enormous potential for American families to save thousands of dollars in energy costs each year, promoting an effective efficiency policy at the federal level is essential. Nearly three-quarters of the homes and buildings that consume over 20% of our nation's energy each year were built before the introduction of modern energy codes in 1991. The families that live in the 95 million oldest, least-efficient homes often cannot afford the upfront costs of energy retrofits and upgrades without meaningful incentives. Additionally, the most-efficient new homes far outpace the older stock, but at a premium that is quickly pricing out families from longer-term energy savings in new housing. A federal policy that combines effective building efficiency incentives to address these cost impacts on consumers, as well as fosters job creation in the hard-hit construction sector, is responsible and necessary for addressing two of the biggest household expenses facing today's families: housing and energy.

In 2005, Congress passed the Energy Policy Act (P.L. 109-58) and established a number of important tax incentives to promote greater energy efficiency in the built environment – single family, multifamily and commercial homes and buildings. These incentives acted as the only federal-level programs to address energy efficiency in new and existing homes and buildings with the intent of moving the market towards greater efficiency and the delivery of

innovation and technology transfer in building design and practice. From the outset, the incentives enjoyed bipartisan support and were initially proposed at much higher dollar levels before being scaled down during final negotiations. Clearly, Congress' intent was to provide incentives to push the market towards greater efficiencies rather than enact rigid mandates that distort the market.

Section 45L – New Energy Efficient Home Tax Credit

The Section 45L tax credit provides a \$2,000 credit to builders of new homes that exceed a minimum energy code specification (2003 International Energy Conservation Code plus the 2004 supplement) by at least 50% in both heating and cooling efficiency. The efficiency performance must be independently verified by an authorized energy rater, and the credit is subject to both a basis adjustment and may not be claimed against alternative minimum tax (AMT) liability. Eligible homes include residences, single-family and multifamily, that are sold to owner-occupants or leased for rental purposes.

Although this credit has suffered from start-and-stop issues of short-term and retroactive extensions over the last five years, and will again expire at the end of 2011, the 45L program has managed to deliver the market transformation results that Congress intended to encourage. The chart below shows that from enactment in 2005 through the end of 2009 (most recent year with available data), the Section 45L credit went from 0.6% of the market to 10% of the market for new homes.

Year	New Homes Sold	45L-Certified Homes	% of Homes Sold
2006	1,052,000	7,110	0.6%
2007	776,000	23,702	3.1%
2008	485,000	21,939	4.5%
2009	374,000	37,506	10%

Data provided by Residential Energy Services Network (www.natresnet.org), 2009.

In 2009, 10% of all the new homes sold met the energy thresholds of the Section 45L credit and were 50% or more energy efficient, with a more than 5-fold increase in total certified homes.

Section 45L is Hampered by AMT Rules and the Basis Adjustment

While claims of the Section 45L credit has grown exponentially, further adoption may be limited by two restrictions imposed under current law. NAHB recommends that Congress enact technical changes to deal with these barriers.

First, the credit cannot be claimed against alternative minimum tax (AMT) liability.¹ As the home building industry is largely comprised of small builders operating as pass-thrus (80% of NAHB builder members are organized as pass-thru entities), many home builders are trapped in AMT status year after year. Because this credit is claimed by the builder, the AMT limitation effectively deters small builders from participating in the program. NAHB believes that homebuyers and renters will be better served if Congress allows all home builders to take advantage of the Section 45L tax credit by allowing it to be claimed against the AMT.

It is also critical that any AMT fix include a retroactive element that allows “credits determined” to the beginning of the program to be claimed against AMT. For those builders who constructed 45L-eligible homes in good faith but have been unable to claim the credit, a retroactive fix is the fairest approach.

In addition to the AMT, Section 45L(e) requires a basis adjustment by the builder when claiming the tax credit. The basis adjustment poses unique challenges to a builder due to the nature of the home building businesses. Generally, builders may construct homes on a speculative or non-speculative basis. Custom built homes are generally constructed on a non-speculative basis and typically with the eventual homeowner acting as the “builder”

¹ The *Creating Small Business Jobs Act of 2010* (P.L. 111-240) allowed eligible small businesses to claim general business tax credits, including Section 45L, against the AMT. This applied only to tax credits determined in 2010, so credits earned from 2005 to 2009 that are carried-forward are not eligible for this AMT exemption.

(owning the lot and the building materials) and the home builder acting as a general contractor providing the service of construction.

The IRS has taken the position that homes built on a non-speculative basis may not qualify for the program *because the builder does not own the property and therefore cannot reduce basis*. Moreover, IRS Notice 2008-35 makes it clear that the eventual homeowner cannot claim the credit as the “builder” because the 45L credit cannot be claimed for a home in which the taxpayer will reside.

NAHB does not believe that Congress intended to exclude non-speculative homes from the tax credit. The ideal solution would be to eliminate the basis adjustment. Realizing this change would result in a revenue impact, NAHB recommends Congress look to a solution that preserves the basis adjustment while allowing all eligible homes to qualify for the credit.

The commercial energy efficient building deduction, Section 179D also requires a basis adjustment but allows the deduction to be claimed by someone other than the building owner in certain cases. Specifically, Section 179D(d)(4) authorizes the Secretary to issue regulations to allow the deduction to be claimed by “the person primarily responsible for designing the property in lieu of the owner,” for certain government-owned buildings.

45L could and should be modified to allow the tax credit to be claimed by the general contractor in custom home building, non-speculative building situations (ones in which the owner of the home and lot will be the eventual homeowners, thereby ensuring the tax credit is consistent with its operation as a general business credit under Section 38). This could be accomplished by granting the Secretary authority similar to that under 179D(d)(4). The ultimate fix could then be done via regulation and would not require modifying the existing basis rules. Custom home builders are the leaders in Green Building, and excluding them from the 45L program reduces the scope and policy effectiveness of the tax credit.

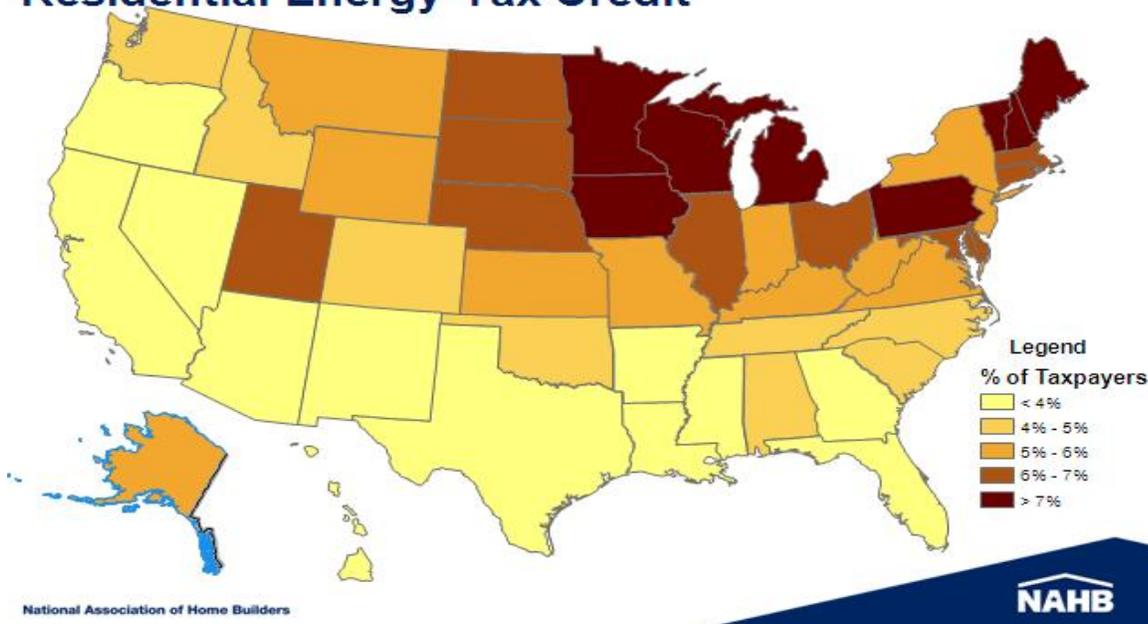
Section 25C – Qualified Energy Efficiency Improvements Tax Credit

The 25C tax credit began as a modest incentive for the purchase of qualified energy efficiency improvements for existing homes, such as windows, doors, roofs, and HVAC

equipment . Originally, the 25C credit provided 10% of the cost of the product (not including installation and labor costs) not to exceed \$500 but imposed various lower caps on specific energy efficient property, such as a maximum of \$200 for window purchases. At the outset, the credit offered little appeal to existing homeowners because the specifications for the qualified improvements had price tags that far exceeded the tax credit. Further, the various caps caused confusion and added complexity. In 2009, the American Reinvestment and Recovery Act (ARRA) expanded the original 25C program and increased the credit to 30% with a \$1,500 cap and included some labor and installation costs. All qualifying products now had the same cap, providing much needed simplicity. As a result, the appeal and popularity of this incentive soared and many retailers, manufacturers, and contractors advertised the newly-enhanced credit which encouraged business and fostered job growth in remodeling activity at the end of 2009 and 2010.

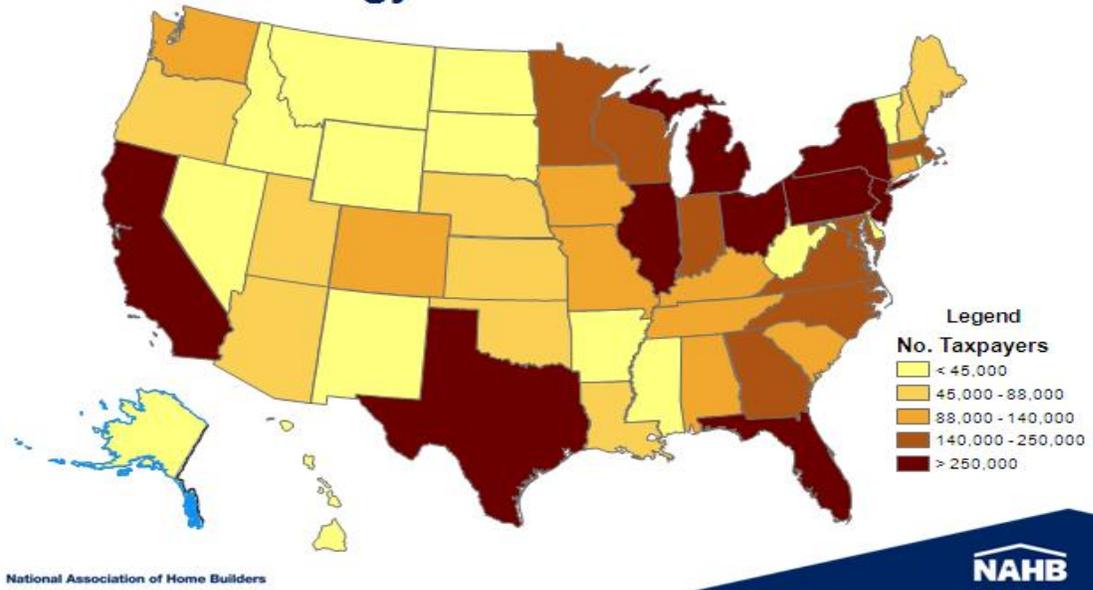
The success of the credit in those two years is unquestionable. Of note, the credit was used heavily in states with an older, less efficient housing stock, and states with more extreme weather conditions. NAHB analyzed Statistics of Income data from the Internal Revenue Service (IRS) about claims for the 25C and 25D (IRS data does not separate out these two credits) and found that in 2009, over 7% of all taxpayers in Minnesota, Iowa, Wisconsin, Michigan, Pennsylvania, Vermont, New Hampshire, and Maine claimed a residential energy tax credit.

Percent of Taxpayers Claiming a Residential Energy Tax Credit



And more than 250,000 taxpayers claimed this credit in California, Texas, Florida, Illinois, Ohio, Michigan, New York, Pennsylvania, and New Jersey.

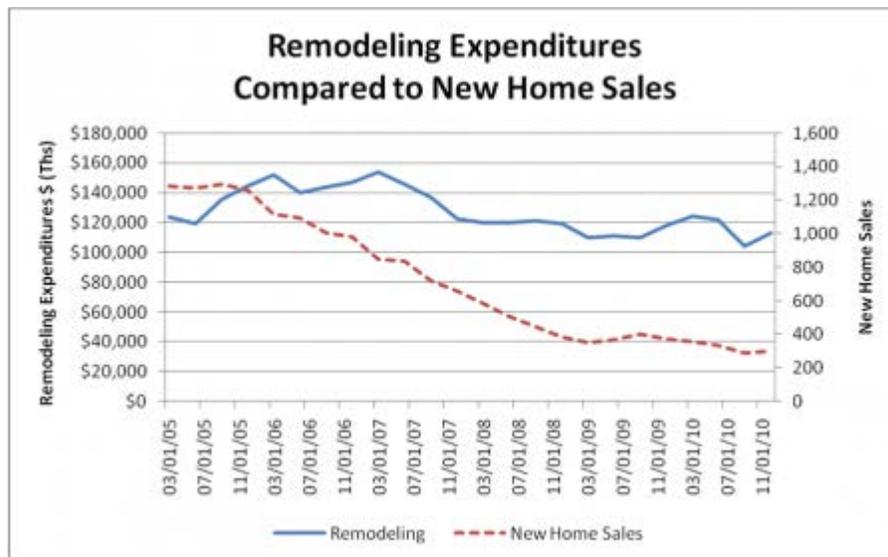
Number of Taxpayers Claiming a Residential Energy Tax Credit



In total, for tax year 2009, nearly \$6 billion of 25C tax credits were claimed. NAHB estimates that these tax credits were claimed in connection with \$20 billion in remodeling expenditures. These tax credits helped support the remodeling industry (see graph below) during a period in which new home sales experienced dramatic declines. NAHB estimates that every \$100,000 creates enough work for 1.11 full-time equivalent jobs.² This suggests the 25C and 25D programs were used in connection with 195,000 jobs.

² THE DIRECT IMPACT OF HOME BUILDING AND REMODELING ON THE U.S. ECONOMY

([HTTP://WWW.NAHB.ORG/GENERIC.ASPX?SECTIONID=734&GENERICCONTENTID=103543&CHANNELID=311](http://www.nahb.org/generic.aspx?sectionid=734&genericcontentid=103543&channelid=311)), NAHB ECONOMICS PAPER.



Unfortunately, this highly successful tax credit reverted back to its 2008 levels for the 2011 tax year. Section 25C now only provides a 10% credit with a \$500 cap, plus assorted lower caps on certain energy efficient property like windows and furnaces. Reverting back to the lower credit, in addition to the complexity of the various caps, will likely discourage consumers from installing more energy efficient property when conducting home renovations. On windows alone, most homes have an average of twelve windows. For a homeowner undergoing window replacement in 2011, the \$200 cap is unlikely to be an effective incentive, and homeowners are more likely to install cheaper, less efficient windows as a result.

Section 25D – Residential Energy Efficient Property

Section 25D provides a nonrefundable 30% tax credit to consumers for the purchase and installation of certain power production property for a home. Typical uses include solar, geothermal, fuel cells, and small wind energy. The credit is uncapped, meaning that all qualified expenses may be claimed. Labor costs are eligible, and unlike Section 25C and Section 45L tax credits, Section 25D credits can be claimed against the AMT.³

³ Although the tax code does not allow taxpayers to Section 25C credits against the AMT, the annual AMT “patch” typically allows taxpayers to claim Section 25C and other personal, nonrefundable tax credits against AMT.

NAHB believes that the simple, straight-forward approach used in Section 25D should be a model for reforming the Section 25C tax credit. A 30% tax credit that includes labor costs and is automatically AMT-preferred is simple, straightforward and effective. Consumers know exactly what benefit they are receiving, which makes it simpler for them to understand both the tax and energy benefits from switching to an advanced system for heating, cooling, and energy production.

Section 179D – Energy Efficient Commercial Buildings Deduction

Section 179D provides a deduction equal to energy--efficient commercial building property expenditures made by the taxpayer. This includes multifamily dwellings built under the commercial building codes (four stories or higher). If a building meets the overall building requirement of a 50% energy savings, the taxpayer may deduct \$1.80 per square foot of the property on which qualifying improvements were made. For buildings that do not reach the targeted energy savings, a partial deduction of \$0.60 a square foot is allowed with respect to each separate building system that meets or exceeds applicable system-specific targets. The taxpayer must obtain an independent certification before the deduction can be claimed.

The only data available about the success, or lack thereof, of this incentive is anecdotal. It is largely unused by the commercial real estate industry at the higher level because of the significant costs associated with a 50% reduction in both heating and cooling costs. Consequently, efforts to redesign this incentive to make it more effective and easier to utilize for existing building retrofits are already underway with a large coalition of support from a diverse set of real estate and environmental interests.

Roll of the Tax Code in Energy Policy

Although some of these incentives would benefit from updates, nearly all of these tax incentives are performing exactly as Congress intended when establishing them back in 2005. Despite the unprecedented downturn in housing and the resultant recession, the increased amount of economic activity associated with retrofit incentives under 25C, coupled with the stellar market penetration of new energy-efficient homes under 45L

confirm that federal policies promoting building efficiency are effective, necessary, and accomplish broad conservation goals.

Some have argued for elimination of all energy and efficiency tax incentives in an effort to let the market determine the direction of costs and savings for consumers. Unfortunately, families that do not have the economic resources to undertake a meaningful energy upgrade will be sidelined in this process. And with or without these incentives, the Department of Energy is on a mission to federalize and mandate aggressive energy code requirements for new homes and buildings that will further deteriorate housing affordability. . Some of these new and proposed requirements will prove to be very expensive to the consumer and will take decades to recover the investment, a payoff few homeowners will see as the average homeowner remains in their home for about ten years while the average home remains in the housing stock for 60 years or more.

Those who suggest that Congress should eliminate incentives to offset these costs on the new construction side, plus remove incentives to upgrade older, less-efficient housing, cannot rely on the market to correct federal agency actions that are not based on a reasonable payback period and cost-benefit analysis. Further exacerbating the situation, appraisals often inappropriately or inaccurately value energy efficiency and energy-efficient features in homes, creating a regulatory disincentive for optional energy efficiency upgrades.

With an aging infrastructure and building stock, more American families are going to be relegated to living and working in less-efficient homes and buildings. New construction is at historic lows, and even when the housing market begins to return to normal levels, consumers will be facing dramatically different mortgage qualification requirements and financing issues than before the downturn. The reality is that the oldest, least-efficient homes are the most affordable to families with lower and moderate incomes. Unfortunately, these families also bear the largest burden in energy costs, as a percentage of income.

Utilization of the tax code to promote energy efficiency and consumer savings is the most effective opportunity to truly shape an efficiency policy that is not punitive to the housing

market as a whole, and create jobs as a result. The use of the tax code to incentivize energy efficiency in buildings has a long history of bipartisan support. Much like other environmental rules and regulations, efficiency requirements are expensive, and ultimately the consumer bears the brunt of those costs. New home builders cannot absorb costly new mandates, and these costs will be passed onto new homebuyers. But to really improve home energy efficiency, we must look at the over 95 million homes that were built before modern energy codes in 1991. Without effective tax incentives, those homes will continue to waste energy and cost the consumer money.