

## CREDIT FOR ENERGY-CONSERVING EXPENDITURES

### EXPLANATION OF THE CREDIT

The 1981 Legislature enacted the credit for energy-conserving expenditures. Section [15-32-109](#), MCA, lists the eligibility criteria:

- ✓ Resident individual taxpayer;
- ✓ **Capital investment** in physical attributes of a **building** or installation of a water, heating or cooling system in the **building**; and
- ✓ Investment must be for an **energy conservation purpose**.

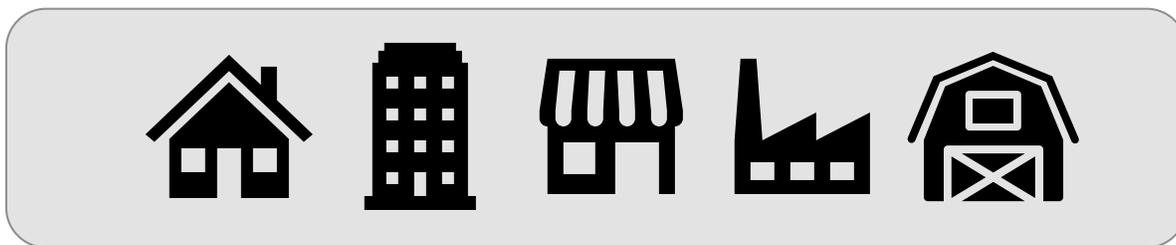
The credit is equal to 25% of the cost, not to exceed \$500. In 2018, 10,033 taxpayers claimed \$4.3 million in credits.

The credit is equal to 25% of the taxpayer's expenditure, but may not exceed \$500. The credit is not refundable and the taxpayer may not carry the credit to another tax year.

ARM [42.4.205](#) allows each taxpayer who makes an energy-conserving expenditure to claim the credit. For example, a married couple who makes a capital investment in their residence may each claim a credit and four individual taxpayers who own a commercial building may each claim a credit for capital investments in the building.

### DEFINITIONS PROVIDE FEW DETAILS ON ELIGIBILITY

Section [15-32-102](#), MCA, defines three terms necessary for determining eligibility for the credit.



**Building** means:

- (a) a single or multiple dwelling, including a mobile home or manufactured home; or
- (b) a building used for commercial, industrial, or agricultural purposes that is enclosed with walls and a roof.

**Capital investment** means any material or equipment purchased and installed in a building or land with or without improvements.

**Energy conservation purpose** means one or both of the following results of an investment:

- (a) reducing the waste or dissipation of energy; or
- (b) reducing the amount of energy required to accomplish a given quantity of work.

CREDITS LIMITED FOR FOSSIL FUEL DEVELOPERS AND NEW CONSTRUCTION

Two sections of law limit the use of the credit for energy-conserving expenditures. Section [15-32-104](#), MCA, limits the credit to persons not primarily engaged in the provision of gas or electricity derived from fossil fuel extraction or conventional hydroelectric development. Section [15-32-105](#), MCA, disallows the credit for a capital investment if that capital investment would have been made under established standards of new construction. The section authorizes the Department of Revenue (DOR) to make administrative rules to implement this intent.

STATUTE PROVIDES LIMITED GUIDANCE ON ELIGIBLE INVESTMENTS

The definition of energy-conservation purpose is limited, requiring DOR to adopt rules identifying investments eligible for the credit. The following table summarizes eligible capital investments and components that do not typically qualify for the credit for energy-conserving expenditures. Capital investments must meet the standards and ratings contained in ARM [42.4.209](#). ARM [42.4.208](#) contains the examples of non-qualifying investments.

Eligible Capital Investments	Ineligible Investments
Insulation of floors, walls, ceilings, roofs, and heating and air conditioning pipes; insulation and sealing of heating, ventilation, and air conditioning ducts; and insulation of hot-water heaters and tanks	Carpeting, carpet padding, other flooring; paint; roof vents; any item with an R value of less than 1; replacing or reshingling a roof; replacing existing asbestos insulation around heating pipes with other insulation
Windows that result in reduction of energy consumption	Awnings that are not part of a qualified passive solar system, movable shades
Insulated exterior doors and storm doors	Garage doors, insulated or not, installed on a garage that does not consume energy other than for lighting and the operation of appliances or power tools; decks
Exhaust fans used to reduce air conditioning requirements	Portable air conditioners
Heat recovery ventilators	Space heaters

Eligible Capital Investments	Ineligible Investments
Caulking and weather stripping that is not part of normal maintenance of a building (such as a log cabin)	Patching holes, replacing foundation, replacing siding
Programmable thermostats	Nonprogrammable thermostats
Replacement of an existing domestic water heater or heating or cooling system	Appliances such as ovens, stoves, refrigerators, dishwashers, clothes washers, and dryers that are not attached fixtures; outdoor grills installed as fixtures
Devices that limit the flow of hot water from shower heads and lavatories	
Glass fireplace doors installed in an existing conventional fireplace	
Replacement of incandescent light fixtures with light fixtures of a more efficient type such as electronic ballast, compact or linear fluorescent lamps, and LED lights	
Lighting controls with cutoff switches to permit selective use of lights	

**PURPOSE IS TO INCENTIVIZE CONSERVATION OF ENERGY**

Section 15-32-101, MCA, is a statement of purpose that applies to the part of law containing the credit for energy-conserving expenditures:

**15-32-101. Purpose.** The purpose of this part is to encourage the use of alternative energy sources and the conservation of energy through incentive programs. The incentives are to be made available to the energy user on a basis that requires the energy user to take the initiative in obtaining a particular incentive. This part allows but does not require a public utility to extend credit for energy conservation investments.

The 1975 Legislature enacted the purpose, and it has changed little since enactment.<sup>1</sup> Other than a change to gender-neutral language in 2009, the only change to 15-32-101 was removal of language providing that the part of law is not intended to require the revaluation of property.<sup>2</sup> The original legislation incentivizing energy conservation

<sup>1</sup> Ch. 548, L. 1975.

<sup>2</sup> Ch. 576, L. 1977.

was formulated as a property tax exemption. The 1977 Legislature changed the tax incentive from a property tax exemption to an income tax deduction and removed the reference to revaluation.

The last sentence refers to a credit in section 15-32-107, MCA, which, prior to July 1, 1995, allowed a utility to pay for installation of energy conservation materials or recognized nonfossil forms of energy generation systems in a residence and for the resident to repay the utility. This credit is no longer used, and the committee may wish to request legislation to repeal the credit and remove the last sentence of the above purpose section. See the section on possible areas for revision for additional information.

## LEGISLATURE MAKES FEW CHANGES TO CREDIT

### 1981: LEGISLATURE ENACTS CREDIT

The 1981 Legislature enacted the credit for energy-conserving expenditures for "capital investment in a building for an energy conservation purpose."<sup>3</sup> The credit was the lesser of \$150 or 5% of the expenditure for a residential building and the lesser of \$300 or 5% of the expenditure for a non-residential building. The credit was not refundable and could not be carried to another tax year.

Existing sections of law containing definitions, limitations, and the application to new construction existed before enactment of the credit and applied to the new credit. These sections previously applied to a 1975 property tax exemption for energy conservation or a recognized nonfossil form of energy generation. The 1977 Legislature replaced the exemption with a deduction for capital investments in a building for energy conservation purposes.<sup>4</sup> That deduction still exists today, though only as a corporate income tax deduction. The Legislature limited the deduction to corporate income taxpayers upon adoption of the individual income tax credit in 1981.

The definitions of "building," "capital investment," and "energy conservation purpose" included in the 1975 property tax exemption legislation remain in effect today. The only change was the addition of "manufactured home" to the definition of "building" in 1997.<sup>5</sup>

### 2001: CREDIT INCREASED TO \$500

The 2001 Legislature revised the credit to its current form and amount.<sup>6</sup> The credit is for "a capital investment in the physical attributes of a building or the installation of a water, heating, or cooling system in the building, so long as either type of investment is for an energy conservation purpose..." The 2001 legislation also removed the

<sup>3</sup> Ch. 480, L. 1981.

<sup>4</sup> Ch. 576, L. 1977.

<sup>5</sup> Ch. 200, L. 1997.

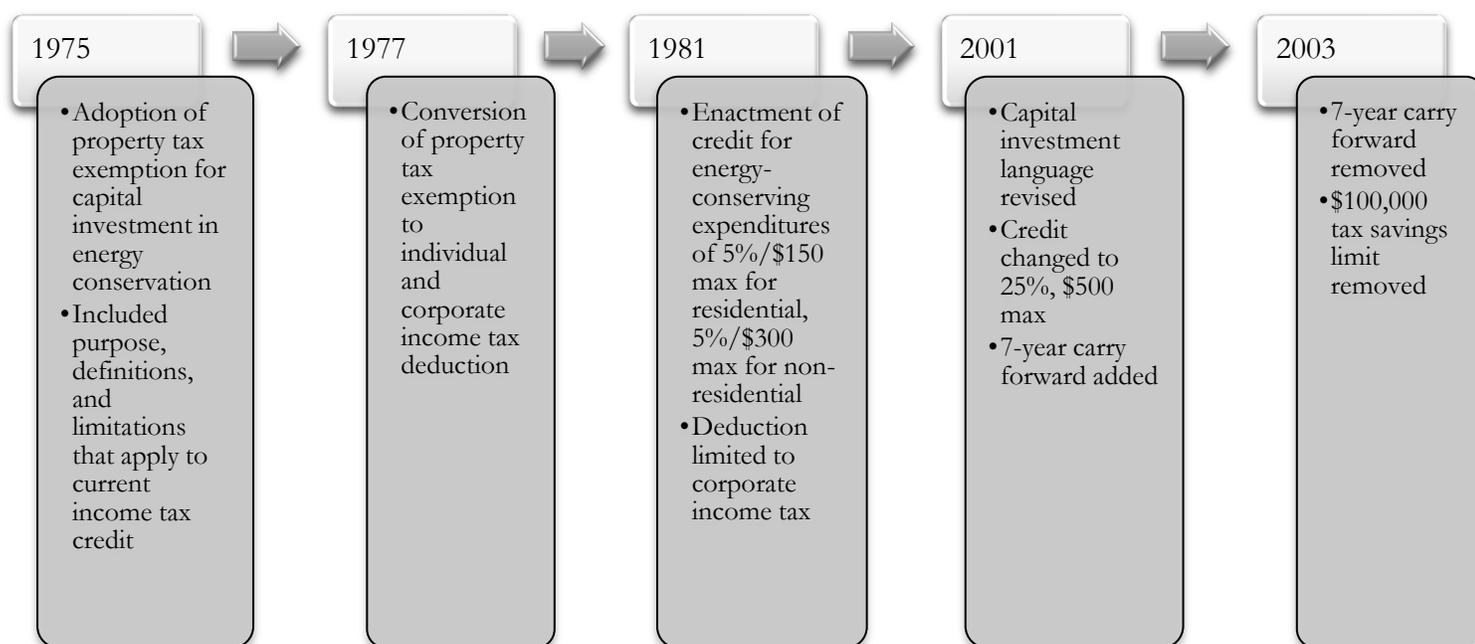
<sup>6</sup> Ch. 591, L. 2001.

different credit amounts for residential and non-residential buildings, increased the credit to 25% of the expenditure, not to exceed \$500, and provided for a 7-year carry forward of any unused credit.

### 2003: CARRY FORWARD REMOVED

The 2003 Legislature removed the 7-year carry forward and a limit of \$100,000 in tax savings contained in [15-32-104](#), MCA.<sup>7</sup> The 1975 property exemption legislation included the \$100,000 limit, but it applied to the credit upon enactment in 1981.

## HISTORY OF ENERGY-CONSERVING EXPENDITURES CREDIT



## TAXPAYER USE OF CREDIT DOWN SINCE 2010

The following table shows the usage of the credit for energy-conserving expenditures. DOR provided the data, which covers the even-numbered years between 1982 and 1988 and all years from 1990 to the present.

This [analysis](#) prepared by the Legislative Fiscal Division shows the average total income of taxpayers claiming the energy conservation credit between 2000 and 2016.<sup>8</sup>

<sup>7</sup> Ch. 524, L. 2003.

<sup>8</sup> Stephanie Morrison, "Individual Income Tax Credit Analysis," September 13, 2018, p. 9.

## 1981-2001: \$150 CREDIT

Before 2001, the credit was 5% of energy-conserving expenditures with a maximum credit of \$150 for a residential property and \$300 for a non-residential property. A taxpayer investing \$3,000 in a residential property or \$6,000 in a non-residential property would get the maximum \$150 credit.

In 1982 and 1984, more than 10,000 taxpayers claimed the credit each year. By 1986 and until legislative changes in 2001, the number of credits claimed declined to less than a quarter of the number claimed in the initial years of the credit. Between 1982 and 2001, the total dollar amount of credits claimed per year ranged from a low of \$95,390 in 1990 to a high of \$987,048 in 1982. The average credit per year ranged from \$44 in 1984 to \$78 in 2001.

Year	Credits Claimed (Number)	Credits Claimed (Dollars)	Average Credit Claimed
1982*	12,880	\$987,048	\$77
1984*	11,418	\$499,146	\$44
1986	2,450	\$119,661	\$49
1988	1,734	\$97,203	\$56
1990	1,430	\$95,390	\$67
1991	1,695	\$116,339	\$69
1992	1,855	\$117,896	\$64
1993	2,104	\$149,970	\$71
1994	2,114	\$150,683	\$71
1995	1,894	\$127,015	\$67
1996	1,791	\$123,749	\$69
1997	1,609	\$120,686	\$75
1998	1,862	\$130,774	\$70
1999	1,777	\$132,907	\$75
2000	1,949	\$141,693	\$73
2001	2,588	\$201,445	\$78

\*Federal credit: 15% of first \$2,000 (maximum value of \$300)

**2002-PRESENT: \$500 CREDIT**

The 2001 Legislature revised the credit for energy-conserving expenditures to 25% of the taxpayer's expenditure with a maximum credit of \$500. The legislation also removed the different caps for residential and non-residential properties.

After increasing the credit, the number and dollar amount of credits claimed generally increased from 2002 through 2010, but mostly declined from year to year since 2010. In 2005, DOR began interpreting the \$500 limit to apply separately to each member of a married couple, so that may account for an increase in the credits claimed.

<b>Year</b>	<b>Credits Claimed (Number)</b>	<b>Credits Claimed (Dollars)</b>	<b>Average Credit Claimed</b>	<b>Credit Claimed Per Montana Resident</b>
2002	4,986	\$1,305,788	\$262	\$1.43
2003	8,916	\$2,440,965	\$274	\$2.65
2004	12,196	\$3,098,479	\$254	\$3.33
2005	17,960	\$5,623,446	\$313	\$5.98
2006*	24,247	\$7,933,053	\$327	\$8.33
2007*	24,866	\$8,090,667	\$325	\$8.39
2008	23,656	\$7,853,727	\$332	\$8.04
2009^	28,594	\$9,998,955	\$350	\$10.16
2010^	28,704	\$10,233,928	\$357	\$10.33
2011*	16,645	\$5,588,577	\$336	\$5.60
2012*	12,887	\$4,510,918	\$350	\$4.49
2013*	12,287	\$4,536,016	\$369	\$4.48
2014*	11,514	\$4,360,886	\$379	\$4.27
2015*	10,776	\$4,176,132	\$388	\$4.05
2016*	10,485	\$4,138,900	\$395	\$3.98
2017*	9,888	\$3,970,515	\$402	\$3.77
2018*	10,033	\$4,264,134	\$425	\$4.01

\*Federal credit: 10%, \$500 lifetime maximum, other maximum for specific items

^Federal credit: 30%, \$1,500 lifetime maximum (2005-2006 does not apply)

## ADDITIONAL CONSIDERATIONS

### TAXPAYERS MAY BE UNCERTAIN ABOUT ELIGIBILITY FOR CREDIT

DOR gets many questions about the credit for energy-conserving expenditures. Taxpayers are confused about the difference between this credit and the credit for alternative energy systems. In addition, the agency receives many questions about which investments qualify for the credit.

DOR provided the following list of sources of confusion or controversy related to the credit for energy conserving expenditures:

- **Assumption that federal credit qualification is same as Montana credit qualification:** metal roof, insulated garage doors;
- **Broad language leads to variety of claims:** livestock waterer, solar panels for livestock wells, gas fireplace insert;
- **Claims for investments with minimal or unproven savings:** TemperShield radiant barrier for insulation;
- **Statute does not specifically exclude routine maintenance:** chinking, caulking, and backing of log home.

The Department of Environmental Quality(DEQ) is tasked in [15-32-106](#), MCA, with providing advice to DOR about a deduction or credit involving energy generation. (*See additional information about 15-32-106, MCA, in next section.*) In addition to this formal role, DEQ has also provided input to DOR on the development of administrative rules for the credit for energy-conserving expenditures. DEQ receives federal funds to promote energy conservation and uses some of that funding to provide [information on its website](#) and publish a brochure about the credit.

### FEDERAL ENERGY CREDITS MAY IMPACT USE OF STATE CREDIT

Montana taxpayers could claim federal and state tax credits for the same expenditures in certain tax years when federal law allowed credits for installing energy-efficient windows and doors or high efficiency heating, cooling, and water-heating appliances.

The federal credits were available until 1985, 2006-2007, and 2009-2018. The federal credit was 15% of the first \$2,000 in the 1980's, and 10% in all other years except 2009-2010. The American Recovery and Reinvestment Act (ARRA) increased the credit to 30% in 2009 and 2010.<sup>9</sup> The credits available in 2006-2007 included a \$500 lifetime maximum. ARRA increased that lifetime maximum to \$1,500 and credits claimed in 2006-2007 did not count

<sup>9</sup> Margot L. Crandall-Hollick and Molly F. Sherlock, "Residential Energy Tax Credits: Overview and Analysis," *Congressional Research Service*, April 9, 2018, and Salvatore Lazzari, "Energy Tax Policy: History and Current Issues," *Congressional Research Service*, June 10, 2008.

towards the maximum. When the credits returned to 10% in 2011, the \$500 lifetime maximum was again in effect and previous usage of the credits applied.

The existence of the federal credit may have increased the usage of the Montana credit. Montana taxpayers claimed fewer credits in the late 1980's through the early 2000's when there were no federal credits, and claimed the most credits in 2009 and 2010 when the federal credits were 30% of expenditures.

## CREDIT REDUCES FEDERAL DEDUCTION FOR STATE INCOME TAXES

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Taxpayers may not claim a deduction for an investment in their residence but may claim a deduction for investment in a commercial building. However, the taxpayer may not claim a deduction and the credit for energy-conserving expenditures for the same investment. The taxpayer could claim the credit for up to \$2,000 in investments (the expenditure required to claim the maximum \$500 credit) and deduct any expenditures exceeding \$2,000.

The benefit of the credit for energy-conserving expenditures for taxpayers who itemize their federal deductions is reduced because the taxpayer receives a smaller federal deduction for state income taxes paid. However, the \$10,000 limit on state and local tax deductions included in the Tax Cuts and Jobs Act may limit the deduction already so there may be no effect from a reduced federal deduction for state income taxes paid because the taxpayer claimed the credit for energy-conserving expenditures.

## POSSIBLE AREAS FOR REVISION

This section identifies possible areas for revision related to the credit for energy-conserving expenditures. The areas identified are intended to make the statute clearer and are separate from any policy changes.

### DOES STATUTE PROVIDE SUFFICIENT GUIDANCE ON ENERGY CONSERVATION?

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The committee should consider whether the definition of energy conservation in statute provides enough direction to DOR on which expenditures qualify for the credit. Consideration of the following questions may be useful:

- Do the expenditures eligible for the credit achieve the purpose of promoting energy conservation?
- Are there expenditures that are not listed as eligible that should be eligible?
- Should any of the eligible expenditures be ineligible?
- Should the statute provide more details about what constitutes energy conservation?

### REFERENCE TO "ENERGY GENERATION" IS OUT OF PLACE

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Section [15-32-106](#), MCA, provides the procedure for obtaining the credit for energy-conserving expenditures and the corporate income tax deduction for energy-conserving expenditures. In two places within the section, there is a reference to "energy generation," but the credit and the deduction are available only for energy conservation and

not energy generation. There is a separate credit available for the installation of an energy system using a recognized nonfossil form of energy, but the procedure in 15-32-106, MCA, does not apply to that credit.

The committee may wish to amend 15-32-106, MCA, so that it applies to the credit for an alternative energy system (15-32-201, MCA). The reference to "a recognized nonfossil form of energy generation" may indicate that the original intent was for this section to apply to the credit for an alternative energy system. There may be value in retaining the language that allows DOR to refer a credit to DEQ for its advice.

**15-32-106. Procedure for obtaining benefit of deduction or credit.** The department of revenue shall provide forms on which a taxpayer may apply for a tax credit under 15-32-109. The department of revenue shall approve a deduction or credit under 15-32-103 or 15-32-109 that demonstrably promotes energy conservation *or uses a recognized nonfossil form of energy generation*. The department of revenue may refer *a deduction or credit involving energy generation* to the department of environmental quality for its advice, and the department of environmental quality shall respond within 60 days. The department of revenue may refer a deduction or credit involving energy conservation to the department of labor and industry for its advice, and the department of labor and industry shall respond within 60 days. The department of revenue may deny a deduction or credit that it finds to be impractical or ineffective.

#### CREDIT FOR INTEREST DIFFERENTIAL IN LOANS FROM UTILITIES NOT IN EFFECT

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Section 15-32-107, MCA, provides for an income tax credit for a public utility or a financial institution that lent money to a taxpayer before July 1, 1995, to install energy conservation materials or recognized nonfossil forms of energy generation systems. A utility could also install the materials or systems and allow the taxpayer to pay back the cost over time as part of the utility bill. The utility or financial institution charged a lower than market interest rate and the credit was for the difference between the interest rate charged and the prevailing interest rate. A public utility could also take the credit against the electrical energy producer's license tax. The Public Service Commission is charged with ensuring the utility does not make a profit when claiming the credit.

This credit was not included in the bill requiring review of tax credits. The credit does not appear on the corporate income tax form and, because loans under the section had to be made prior to July 1, 1995, there is no indication that a utility or financial institution would still be collecting interest on the loan and thus eligible for the credit.

The credit is reproduced below for reference. The committee may wish to recommend repeal of the credit or recommend including the credit in the Revenue Interim Committee review process required in section 15-30-2303, MCA. The committee may also wish to recommend striking the last sentence of the purpose section, 15-32-101, MCA, because that section refers to the loan program that existed before 1995.

**15-32-107. Loans by utilities and financial institutions — tax credit for interest differential for loans made prior to July 1, 1995.** (1) Except as provided in subsection (4), a public utility or a financial institution that lent money or made qualifying installations under this section as it read prior to July 1, 1995, may compute the difference between interest it actually receives on the transactions and the interest that would have been received at the prevailing average interest rate for home improvement loans, as prescribed in rules made by the public service commission. The utility may apply the difference so computed as a credit against its tax liability for the electrical energy producer's license tax under 15-51-101 or for the corporate income tax under chapter 31, part 1. The public service commission shall regulate rates in such a manner that a utility making loans under this section may not make a profit as the result of this section. The financial institution may apply the difference so computed as a credit against its tax liability for the corporate income tax under chapter 31, part 1.

(2) A utility may not claim a tax credit under this section exceeding \$750,000 in any tax year. A financial institution may not claim a tax credit under this section exceeding \$2,000 in any tax year.

(3) The public service commission may make rules to implement this section as it applies to public utilities only.

(4) A public utility whose purchases of or investments in conservation are placed in the rate base as provided in Title 69, chapter 3, part 7, may not receive a tax credit under subsection (1).

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