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# Investment Tax Credit for Geothermal Heat Pumps (GHPs)

Geothermal heat pumps (GHPs) draw on the Earth's ambient temperatures to heat and cool commercial buildings. The Investment Tax Credit (ITC) is a dollar-for-dollar federal Credit that can directly reduce tax liability on GHPs by 30% or more, offsetting the cost of installation and incentivizing further use of this zero-emission technology.

Especially useful for schools and hospitals that need extensive, reliable HVAC, these systems continue to grow in popularity among non-profits. Fortunately, under the Inflation Reduction Act, tax-exempt entities can also benefit from the ITC.

## ELIGIBILITY CRITERIA

The credit may be claimed on new construction and retrofits that install GHPs, assuming the following conditions are met:

- Building must be in US
- Construction must begin before 1/1/2035 (though 2032 is cutoff for maximum Credit value)
- Equipment must use ground/groundwater as a heat source/heat sink to heat/cool building
- Original use of the equipment must begin with the taxpayer

Dual use equipment is also eligible for the Credit, as long as at least 75% of the energy input is geothermal. This "75% Cliff" allows hybrid GHP systems to incorporate a backup/emergency energy source while remaining eligible for the ITC.

## CLAIMABLE COSTS

Under the ITC, taxpayers can recoup up to 50% of their spend on functionally interdependent GHP system components.

This includes all system components – everything from the geothermal wells and pumps at the surface to the air handlers and ductwork in the building – plus all the converters, furnaces, and blowers in between.

Costs may also include fees paid to system designers and monies paid for pre-installation feasibility studies.

## DIRECT PAY FOR TAX-EXEMPT ENTITIES

Under the OB3, government and tax-exempt entities can claim energy incentives using a process known as direct or elective pay. This mechanism allows them to transfer energy credits like the ITC into a check for the Credit's full value.

Eligible entities include:

- Non-profits
- Colleges
- School Districts
- State and local governments
- Religious organizations


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## ITC BENEFIT RATE

| | Small GHP Project (>1MW Output) | GHP Project with PWA Satisfied | GHP Project without PWA |
|---|---|---|---|
| Base Credit Amount | 30% | 30% | 6% |
| Bonus: Domestic Content | 10% | 10% | 2% |
| Bonus: Energy Community | 10% | 10% | 2% |

The base credit rate is 6%, but the total rate depends on several factors:

- Satisfaction of Prevailing Wage & Apprenticeship Requirements (PWA)
  - If these requirements are met, the base credit quintuples to 30%
- Project Size
  - Projects with an output of >1MW are eligible for a 30% base credit regardless of PWA status
- Bonus Factors
  - Domestic Content: An additional 10% bonus credit is available if all structural steel and iron was produced domestically. (This bonus drops to 2% if PWA Requirements are unsatisfied.)
  - Energy Community: An additional 10% bonus credit is available for projects located in Department of Energy-designated energy communities. (This bonus drops to 2% if PWA Requirements are unsatisfied.)

Many geothermal projects are able to reclaim 50% of system cost under the ITC.

## ITC TIMING

Unlike other renewable energy systems, geothermal projects were not shifted from Sec. 48 to Sec. 48E under the OB3. As such, they were not assigned a sunset date, affording developers long term certainty for predictable planning.

- Geothermal projects will begin to phase out after 12/31/2032
  - Projects PIS in 2033 will claim a base Credit of 5.2%
  - Projects PIS in 2034 can claim a base Credit of 4.4%
- Unless extended, the ITC for GHPs will sunset after 2034

## STACKING THE SAVINGS

When ITC is on the table, other tax strategies may often apply, teeing up extra savings.

- An ITC Study is an easy add-on to a Cost Segregation Study is already quantifying and assigning costs to all building assets
- Components of the GHP may also be eligible for accelerated and bonus depreciation, and Cost Segregation will unlock that yield
- Additionally, if the installation of a GHP was just one of multiple energy-efficient features incorporated into a property, the 179D Deduction may also be in play
- Many taxpayers are able to successfully stack benefit from the ITC atop benefit from Cost Segregation and 179D Deduction
- Additionally, if you're installing a GHP in a manufacturing facility you might also benefit from a Predominant Use Study to minimize utility tax burden

## NEXT STEPS

This incentive doesn't have a sunset, but will eventually phase out. Timely planning with a quality provider is key.

*Let's talk.*

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