

RENEWABLE ENERGY *INSIGHTS*

Forward Thinking Thought Leadership

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CohnReznick—CALSEIA ITC Webinar: FAQs

On February 17, 2016, CohnReznick and CALSEIA hosted a webinar to discuss a number of financing questions pertaining to the investment tax credit (ITC). The questions asked, along with responses to these questions, are provided below.

Please note that the responses are very general in nature and should not be treated as advice. The facts and circumstances for a specific case related to the ITC will help to determine the ultimate outcome. You should seek counsel from an experienced tax accountant and/or attorney prior to moving forward with any development and/or investment plans.

Q: What are the current ITC rates?

A: For either type of ITC credit below, the tax credit is generated when the system is placed in service (PIS).

1) 25D (residential): Solar Electric and Water Heating

- Law effective before 1/1/2017
 - i. PIS through 12/31/2016 – 30%
- Law effective after 12/31/2016
 - ii. PIS before 12/31/2019 – 30%
 - iii. PIS 1/1/20 through 12/31/2020 – 26%
 - iv. PIS 1/1/21 through 12/31/2021 – 22%
 - v. After – 0%

2) 48 (commercial): Solar Electric and Water Heating

- Commence construction before 12/31/2019 – 30%
- Commence construction 1/1/20 through 12/31/2020 – 26%
- Commence Construction 1/1/21 through 12/31/2021 – 22%
- Must be PIS by 12/31/23 to claim credits above
- After – 10%

Q: Has the IRS published any definitive commence construction rules for the IRC 48 credit?

A: Not yet, but we expect the IRS to do so in time.

Q: What is the eligible basis for ITC purposes?

A: Generally, this is equal to the depreciable basis of the solar system assets. The depreciable basis for solar generally includes the cost incurred to build and/or develop the project. This may include the panels, racking, wiring, permitting, engineering, and the otherwise allowed and properly capitalized legal cost for the EPC/developer fee.

The costs not included in eligible basis are generally associated with the operation of the project (PPA/interconnect), the costs to organize the ownership structure (legal costs), and the land and reserve costs. Financing fees associated with a construction loan are generally eligible if the construction/permanent loans are separately issued (different closings). Otherwise, it is required to proportionally allocate the cost over the combined term. Buildings and structural components of buildings, while depreciable, are not included in eligible basis. Transmission costs are not included in eligible basis, nor are intangibles.

Q: What is the basis of property for ITC in a prepaid lease off-take contract?

A: Same as above.

Q: How do roofing costs or carport mounting associated with solar projects affect ITC basis?

A: The specific facts and circumstances will govern this. Roofing costs are generally ineligible. To the extent there are exterior support systems added specifically to maintain the weight of the racking system, these could be eligible. The same is true for carport mounting. Elevated mounting brackets could be eligible for ITC basis. Facts will govern.

Q: Can the cost of additional solar panels added onto an existing project be eligible for ITC?

A: Yes, this is generally the case to the extent that the panels are new equipment and are not intended to replace any of the existing panels.

Q: Can customers claim the ITC for battery storage / management systems added AFTER the initial PV system was placed in service?

A: While the issue is not always clear, it appears that, yes, this is generally the case if the battery is new equipment added on to a qualified renewable energy project. The IRS is expected to issue new guidance on this issue, as well as other storage-related issues, in the future.

Q: How does energy storage qualify for ITC?

A: Generally, energy storage is eligible if the power source for the storage is from solar. To the extent that the battery uses renewable and non-renewable sources for power, the IRS has determined limits on the qualification of this dual-use equipment for ITC purposes. Please see IRS Regulations under section 48 for the current 'cliff test' rules and see also relevant other IRS rulings.

Q: How many years can the credit be rolled over and is there any percentage deduction during rollover years?

A: If the 25D credit goes unused in a year, it can roll forward for as long as the 25D credit remains allowable—currently through 12/31/21. Should the 48 credit go unused in a year, it can be carried back one year and carried forward for 20 years. There is no reduction to the 25D or 48 tax credit in either case if these credits are carried back or forward.

Q: Who can get the 1603 grant in lieu of ITC? What is the tax basis for ITC, and is it different for 1603 grant?

A: Generally, anyone who already has submitted a proper grant application prior to the 10/1/12 deadline and has met one of the "begun construction tests" is eligible.

The basis for the ITC is the depreciable basis of the costs. The 1603 grant was intended to mimic the ITC except that, due to sequestration, every award made on or after 10/1/15 and on or before 9/30/16 will be reduced by 6.8%. This reduction is irrespective of when the application is received by Treasury. This rate is only for the current fiscal year and sequestration will continue to apply at a TBD rate after September 30, 2016.

It is important to note that Treasury reviews every application in detail before a grant award is made and may exclude or reduce eligible basis if they believe costs/fees are out of line with other applications they have received. This is not the process with the ITC.

Q: Can you install solar property on rental properties you own and have it qualify for the ITC?

A: Yes. But it would be deemed IRC 48 business property. It would be important for the property owner to speak with an accountant to make sure they are aware of the 465 and 469 at-risk and passive activity rules and whether they can use the ITC and related depreciation. The rules are not the same for the 25D credit because rental property is not a "personal residence" to its owner but rather business use property.

Q: Can a homeowner take the 25D ITC when their condominium association pays for a qualified solar system?

A: Yes. Per 25D, the homeowner will be treated as having made the individual's proportionate share of any expenditures of such association. See IRS Q&A which deals with this in depth.

Q: What are the placed in service (PIS) rules?

A: The determination of when property is placed in service for the section 48 ITC is highly fact specific. A good place to start is by ensuring that each of the following 5 factors discussed below has been met. Other facts and circumstances can alter this. Please be sure to consult with your tax advisor based on your specific facts and circumstances.

Power plants are considered placed in service when 5 things have occurred:

1. The equipment has been delivered and physical construction or installation on site has been completed. Contractor personnel can still be at the site in support of startup and maintenance and completing minor tasks like painting and attending to punch list items.
2. Preoperational tests have demonstrated that the project can serve its intended function. Other testing to determine whether it can operate at the design capacity, and to identify and eliminate defects, can occur after the project is placed in service.
3. The taxpayer has taken legal title and control over the project.
4. The project is able to deliver its electricity to market.
5. The taxpayer has obtained the licenses and permits needed to operate the project.

The IRS takes the position that equipment must be in "daily operation" to be considered in service. In Technical Advice Memorandum 9405006, the IRS stated that a power plant is considered in daily operation when it is routinely operating to supply power to the transmission grid for sale to customers. This reflects a conservative view of the law. The real issue is whether the facility is capable of being used for its intended purpose, and daily operation is one way to prove it. For example, Rev. Rul. 79-98 provides that a facility is placed in service when a state of readiness and availability for a specifically assigned function, such as daily operation, has been demonstrated.

Q: Is there expiration to the current five year MACRS depreciation schedule?

A: Not currently.

Q: What about bonus depreciation?

A: The recent Protect Against Tax Hikes (PATH) tax act extended bonus depreciation. The current schedule allows for:

- 50% bonus depreciation for systems PIS through 12/31/17
- 40% bonus depreciations for systems PIS post 17 through 12/31/18
- 30% bonus depreciation for systems PIS post 18 through 12/31/19

Additional detailed rules also apply.

Q: What are the rules for depreciation and rollover?

A: To the extent that a project has net operating losses (NOLs), which are the excess of deductions over income, they can generally be carried back two years and forward for 20 years.

Q: What is the resulting tax depreciable basis after accounting for the ITC?

A: For single-tier, non-lease pass through structures, the final available depreciable basis for an IRC 48 solar deal using depreciable basis as eligible basis is 85% of the ITC eligible original depreciable basis. The IRC requires the owner to reduce their depreciable basis by ½ of the ITC or 1603 grant claimed.

Q: Do large utility-scale projects currently qualify for bonus depreciation?

A: As long as they are placed in service during one of the time periods mentioned above, then, generally, the assets with a class life of 20 years or less will qualify for bonus depreciation.

Q: What are the current rules pertaining to Pre-paid lease/ Pre-paid PPA treatment?

A: Pre-paid leases in general are a permitted financing tool but a great deal of diligence should be used when employing them. Under IRC section 50, leases to tax-exempt entities eliminate the ability for an owner to receive the ITC. If the off-taker is a tax-exempt, a PPA or service contract as defined in IRC 7701(e) should be used to the extent state law otherwise allows it.

Q: Is there any easy way to set up a method to allow church members to invest in a system for their church and use the ITC for members?

A: Potentially, because the church is likely tax exempt, the best way is to structure the off-take as a PPA and have the members form an LLC that owns the project and sells the energy to the church. The members in the LLC would receive their pro-rata ownership. At-risk and passive activity rules under 465 and 469 must be carefully considered.

Q: What are the rules for operating vs. capital lease treatment?

A: The capital lease rules are somewhat extensive. However, if a lease is treated as a "capital lease," the tax ownership of the system transfers to the lessee of the equipment. This can ruin a financing package and the ability to claim the ITC.

Fully prepaid leases and bargain purchase options (below FMV) are things to watch for as they could trigger capital lease treatment. Prepaid leases fall under IRC 467 and the income should be recognized based on a calculated amortization schedule over the course of the prepaid lease period.

Prepaid PPA's should be booked as a liability and amortized over the life of the PPA.

Contact

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About CohnReznick

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About CALSEIA

Since the 1970s, CALSEIA has advanced the common interests of the solar industry, helping make California's solar market the most robust in the United States. Comprised of over three hundred and fifty contractors, manufacturers, distributors, developers, engineers, consultants, and educational organizations, CALSEIA represents a diverse membership committed to growing the California solar industry. CALSEIA engages with local and state decision makers to ensure California remains a solar energy leader through good public policy and regulations that provide clarity, transparency, and certainty. More info at www.calseia.org.

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