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Tax Credit Bill Brightens Large-Scale Solar's Future

By **Keith Goldberg**

Law360, New York (February 10, 2014, 5:25 PM ET) -- The bipartisan U.S. Senate bill floated last week allowing solar energy projects to collect the federal investment tax credit as long as construction starts before the credit expires in 2017 would provide a much-needed extension for large-scale solar developers heavily reliant on the subsidy and allow far more projects to qualify for it, attorneys say.

Under the current rules, solar projects must be placed in service by the end of 2016 in order to qualify for the investment tax credit, or ITC, which provides an incentive equivalent to 30 percent of the initial cost of wind, solar and fuel cell systems, or 10 percent of the cost of geothermal, microturbine and so-called combined heat and power systems.

The bill pitched by Sens. Michael Bennet, D-Colo., and Dean Heller, R-Nev., throws the solar industry the same bone that Congress threw the wind industry at the end of 2012, when it extended the production tax credit, or PTC, for another year and said wind developers could collect it as long as they began construction by the end of 2013.

"The way they can pitch this on the Hill is that you've provided this beginning-of-construction test for wind and other renewable energy sources; this would create parity for the solar industry," said David Lowman Jr., who co-chairs Hunton & Williams LLP's global renewable energy practice group. "The way to look at it, [solar developers] are getting an extension here ... at least a one- or two-year extension, depending on the size of the project."

That's much-needed relief for developers of large-scale solar projects, which have longer timetables because of hurdles such as environmental permitting and negotiating power purchase agreements, according to attorneys.

"If you were about to start a project that you expect under a normal construction schedule would not be completed until the end of 2016, you might not undertake the project due to the risk it might slip past that date and cost you the 30 percent ITC," said Jeff Davis, a Mayer Brown LLP tax partner and co-head of the firm's renewable energy group. "The bill will remove a lot of the risk for developers to begin construction of really large projects that they might not be confident they can complete by the end of 2016."

Large-scale projects may be the biggest winners, but smaller-scale projects such as residential solar installations that use leasing or power purchase agreements would benefit as well, attorneys say.

The ITC has been just as crucial to the rapid development of the solar industry as the PTC — which hasn't been renewed after being allowed to expire at the end of 2013 — has been to the development of the wind industry.

"Many of the solar companies started out as fairly small-scale operators and not necessarily well-capitalized," Lowman said. "They brought in a lot of the cash through companies capitalizing on the tax credit."

And while the ITC has become less important as the prices of solar panels and other components continue to drop, developers need the credit to attract investors who still may be cautious on renewable projects, according to attorneys.

"Not to say you couldn't have some projects that could survive, but they'd be the exception rather than the rule," said Greg Jenner, a former head of the U.S. Department of the Treasury's office of tax policy who co-chairs Stoel Rives LLP's energy team. "The industry is still evolving substantially."

If the bill makes it into law, then the question becomes, what constitutes the start of a project's construction? The Internal Revenue Service attempted to answer that question in regard to the PTC in a series of guidances issued last year.

In April, the IRS stated that projects would be eligible in 2014 for the PTC if developers start significant physical construction work this year or spend more than 5 percent of the project's total cost in 2013.

The agency modified the guidance in September, saying that developers wouldn't have to show continuous efforts toward construction work after this year to stay eligible for the PTC as long as the projects were in service by Jan. 1, 2016. The IRS also said that a project's construction start date and resulting tax credit are project-specific, not taxpayer-specific, according to experts. That means even if a qualified project changes hands or acquires investors, the new investors will still enjoy the tax benefits.

Much of this guidance can be applied to determining ITC eligibility for solar projects, attorneys say.

"There won't be a whole new learning curve because it's a different technology," McDermott Will & Emery LLP energy tax team leader Phil Tingle said. "I don't think [the IRS would] be obliged to create a whole new tax analysis for solar."

However, the IRS still left some unanswered questions out there, such as how much physical construction work is needed to qualify for a tax credit. Simply saying the existing guidance can be applied to ITC-seeking solar projects wouldn't solve that issue, attorneys say.

"It appears that the bill's sponsors contemplate 'meaningful' construction. What does that mean?" Davis asked. "Is that the same as physical work of a significant nature, which is what the IRS requires for the PTC and wind? There continues to be a lot of uncertainty about how the begun-construction requirement is met for the PTC."

Firmly establishing how all renewable projects can qualify for the credits would reassure not only developers but also their prospective tax equity investors, who tend to be a conservative and nervous lot, according to attorneys.

"If this bill is enacted, it would be helpful for Congress to give some signal to the IRS as to what it takes to qualify as beginning construction," Davis said.

--Editing by Jeremy Barker and Edrienne Su.
