

For Solar Industry, Obama's REIT Rewrite Falls Flat

By **Keith Goldberg**

Law360, New York (May 15, 2014, 3:16 PM ET) -- The Internal Revenue Service's proposed update of its definition of "real property" in the real estate investment trust realm was trumpeted by the Obama administration as a boon for solar power development, but experts say the new guidelines are too narrow to be of any real use for large-scale projects.

Taxpayers that want to qualify as REITs must keep at least 75 percent of their total assets in real estate assets such as real property, interests in that property, cash and cash items, according to the Internal Revenue Code.

The proposed regulations released Friday — and touted by President Barack Obama in a speech championing increased solar energy use that same day — indicate that supporting materials for the electricity-generating solar photovoltaic modules, such as wires and foundations, may qualify as real property because they're inherently permanent structures. But the PV modules themselves would not qualify.

The regulations also indicate, through a set of solar project examples, that a qualifying REIT needs to both own the solar project and the building the project is supplying power to, while occasionally sending excess electricity back to the grid.

For a clean-energy industry hoping the Obama administration would expand the scope of REITs to cover all solar projects, as well as other types of renewable energy projects, Friday's proposal was a major letdown, experts say.

"The big takeaway is that the president gave a speech about renewable energy that promised updated guidance that got the solar industry very excited, and then a few hours later, Treasury released the guidance, and it deflated the balloon," said David Burton, an Akin Gump Strauss Hauer & Feld LLP tax partner. "This really confirms that the IRS and Treasury Department are not comfortable with REITs owning electric generation, be it solar or anything else."

For one, the proposed regulations effectively eliminate the REIT option for utility-scale solar projects, experts say.

"It's pretty clearly saying that utility-scale solar doesn't qualify, because you're selling power to a utility or qualifying merchant company, and it's silent on financing residential solar," Burton said. "So all that's left is distributed generation, but it's saying distributed generation is OK where you have a fact pattern

where a REIT project owns the project as well as the building."

Solar project owners typically look to sell their power to a utility or other buyer through a power purchase agreement and don't usually own the buildings that would be powered by their projects as well, experts say.

"That makes sense for a hotel or an office building," Chadbourne & Parke LLP partner John Marciano said. "It doesn't really make sense for a typical developer that wants to raise capital for a project."

The agency's proposed regulations float a test for taxpayers to determine whether particular assets are land, inherently permanent structures or structural components. The solar project examples provide a useful framework for conducting that test for developers seeking the REIT option but will be difficult to apply where solar equipment exhibits conflicting factors, according to Mayer Brown LLP tax partner Jeff Davis, the co-head of the firm's renewable energy group.

"So while the proposed regulations are helpful, there remains a lot of uncertainty," Davis said.

The IRS is accepting comments on the proposed regulations for the next 90 days. Experts say one of the main sticking points for the solar industry will likely be the requirement for a REIT to own both the solar project and the building it's supplying power to.

There's also concern that the real property classifications of some solar equipment could conflict with the federal investment tax credit, which provides an incentive equivalent to 30 percent of the initial cost of wind, solar and fuel cell systems.

Because REITs can only use the ITC to the extent they don't obtain a tax deduction by paying a dividend — and they must pay a dividend for 90 percent of their taxable income — they generally don't need the credit, according to Burton. But to qualify for the ITC, a solar project has to be classified as equipment or personal property, he said.

"If I'm not a REIT, is some IRS auditor going to say to me that my solar project, in some factor, is real estate?" Burton asked. "You don't want to give an auditor a foothold to start making trouble. You don't want any suggestions that you're not going to get your 30 percent ITC."

The IRS and Treasury Department said they view the proposed rules as a clarification to help taxpayers determine just what assets REITs can invest in. In that sense, experts say the agencies accomplished that mission, even if solar developers didn't get the favorable tax treatment they were hoping for.

"It's not a big breakthrough, but it does make the rules fairly clearer, and I did think they did a good job with that," said Micah Bloomfield, a Stroock & Stroock & Lavan LLP tax partner. "Everyone won't have to go in for their own private letter ruling now."

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