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Good And Bad News For Renewable Energy Tax Credits

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Jeffrey G. Davis

The Consolidated Appropriations Act of 2016 (P.L. 114-113) brings both good news and bad news for taxpayers with an interest in energy tax credits. On the one hand, the act extends the time periods during which certain credits are available. These credits include the solar investment tax credit and the wind production tax credit. On the other hand, the act also introduces phaseout dates with respect to these tax credits, indicating that the era of these energy tax credits may be approaching its end.

The act extends the 30 percent solar investment tax credit (ITC) under Internal Revenue Code (the "Code") Section 48 to solar energy property that begins construction prior to Jan. 1, 2022 (under prior law, the cutoff date was Jan. 1, 2017). This legislative change represents not just an extension of the time the credit is available, but also a change from the old "placed-in-service" requirement to a "begun construction" standard, thus bringing the solar ITC in line with the standards applicable to the wind production tax credit.[1]

However, the act also implements a three-step phaseout for solar energy property. Although the energy percentage for the energy credit will remain at 30 percent of the basis of each energy property placed in service during the taxable year for a period, the energy credit will generally be 26 percent for property that begins construction in 2020 and 22 percent for property that begins construction in 2021. The energy credit will be further reduced to 10 percent if such solar energy property is not placed in service prior to Jan. 1, 2024.

The renewable energy production tax credit (PTC) under Code Section 45 for facilities using wind to produce electricity is extended to facilities that begin construction before Jan. 1, 2020 (the previous expiration date was Jan. 1, 2015). The act also phases out the wind PTC, which generally is an amount equal to the product of 1.5 cents (adjusted for inflation, which for 2015 resulted in a credit rate of 2.3 cents) multiplied by the kilowatt hours of electricity produced by the taxpayer and sold to an unrelated person, by providing that the amount of the credit shall be reduced by 20 percent for facilities that begin construction during 2017, 40 percent for facilities that begin construction during 2018 and 60 percent for facilities that begin construction during 2019.[2]

The election to treat qualified wind facilities as energy property under Code Section 48(a)(5) (such that the ITC may be claimed in lieu of the PTC) is likewise extended to facilities that begin construction before Jan. 1, 2020.[3] Under the election, the phaseout would again reduce the credit by 20, 40 and 60 percent, respectively, for facilities that begin construction in 2017, 2018 and 2019.[4]

The following table sets forth the amount of the ITC, the PTC and the ITC in lieu of the PTC for each year through the applicable phaseout period:

Year of Begun Construction	**ITC Amount (assuming property is placed in service prior to January 1, 2024, otherwise 10 percent)**	**PTC Amount (assuming no inflation or deflation)**	**Election to Claim ITC for Wind Projects**
2016 and earlier	30 percent	$0.023/kWh	30 percent
2017	30 percent	$0.0184/kWh	24 percent
2018	30 percent	$0.0138/kWh	18 percent
2019	30 percent	$0.0092/kWh	12 percent
2020	26 percent	$0	Not available
2021	22 percent	$0	Not available

The act has also extended until the end of 2016 the PTCs for closed-loop biomass facilities, open-loop biomass facilities, geothermal and solar energy facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.[5] The election to treat these facilities as energy property under Code Section 48(a)(5) has also been extended to facilities that begin construction before Jan. 1, 2017. With respect to individuals, the act provides for the extension of credits through Jan. 1, 2022, for certain solar and qualified solar water heating properties under Code Section 25D, and also the phasing out of those credits.[6]

Bonus first-year depreciation for certain qualified property (including energy property) has also been extended under the act to include property acquired before Jan. 1, 2020 (formerly property acquired before Jan. 1, 2015).[7]

Stakeholders have welcomed the added certainty regarding the availability of the ITC and the PTC through 2021 and 2019, respectively. The ITC and the PTC, and the tax benefits from accelerated depreciation, have been extremely effective at galvanizing the U.S. renewable energy industry in recent years, contributing substantially to its impressive growth. Large-scale renewable energy projects, and the concomitant jobs and boost to the economy, have relied heavily upon “tax equity financing,” of which tax credits are a central component. Without the effective subsidy provided by the tax credits, solar and wind energy are still not economically competitive in many areas of the country. Additionally, past uncertainty as to whether the ITC and PTC would be renewed has limited growth and job security in the solar and wind energy industries.

Despite the industry’s rejoicing at this extension and the expected benefits, the gradual phaseouts will create pressure to begin the construction of energy facilities prior to certain phaseout dates, which will offset to some extent the benefits associated with certainty and the opportunity for long-term planning. Additionally, the gradual phaseouts indicate that Congress may not continue to renew the solar ITC and wind PTC on an annual basis after the final phaseout dates. The phaseouts of these energy credits also line up with the expected dates for full implementation of the Clean Power Plan.[8]

Even if consensus as to the dates of the phaseouts were to change, and congressional impetus were to move back in the direction of continuing to extend the solar ITC and wind PTC beyond 2021 and 2019, respectively, it would likely be more difficult for Congress to enact such a renewal. This is because the other tax extenders that have previously expired and been extended in lockstep with the energy credits now have different expiration dates, or, in the cases of the research and development tax credit and the Code Section 179 expensing for capital investment, have been extended indefinitely. As a result, momentum to extend the application dates of the energy credits would be reduced without these other extensions also being on the line.

However, it is not impossible that these credits will be extended beyond the final phaseout dates under the act.[9] It is also possible, particularly given the permanent adoption of the research and development credit, that credits similar to the solar ITC and wind PTC will be enacted for newly discovered or commercialized renewable and alternative energy sources and technologies in the future.

Extension of IRS Guidance

As discussed above, the act extends the time period in which the PTC may be claimed. This is not the first time that the PTC has been extended. Prior to enactment of the act, the PTC had last been extended from Jan. 1, 2014, to Jan. 1, 2015, by the Tax Increase Prevention Act of 2014. Prior to such extension, the Internal Revenue Service had issued guidance with respect to the PTC in the form of a series of notices (the “prior guidance”) to clarify when construction of a facility was deemed to have begun.[10] Broadly speaking, IRS Notice 2013-29 provides that a taxpayer can establish that construction has begun by starting physical work of a significant nature (the “physical work test”) or by paying or incurring at least 5 percent of the total cost of the facility before Jan. 1, 2014 (the “safe harbor test”).

In addition, under the prior guidance, the physical work test requires the taxpayer to maintain a continuous program of construction, while the safe harbor requires that the taxpayer make continuous efforts to advance toward completion of the facility (together, the “continuity requirement”). IRS Notice 2013-60 clarifies that the continuity requirement would be deemed satisfied if the facility is placed in service before Jan. 1, 2016.

While the prior guidance was limited to establishing whether construction had begun prior to Jan. 1, 2014 (i.e., the cutoff date for PTC eligibility prior to enactment of the Tax Increase Prevention Act of 2014), in IRS Notice 2015-25, the Service extended by one year the date by which the physical work test or safe harbor must be satisfied to reflect the one-year extension of the PTC pursuant to the Tax Increase Prevention Act of 2014.[11] Consistent with the Service’s extension of the prior guidance in response to the one-year extension of the PTC pursuant to the Tax Increase Prevention Act of 2014, we would expect that the Service would similarly extend the date by which the physical work test or safe harbor must be satisfied to reflect the extension of the PTC pursuant to the act.

In addition to extending the date by which the physical work test or safe harbor must be satisfied, IRS Notice 2015-25 extended the placed-in-service date for the deemed satisfaction of the continuity requirement to Jan. 1, 2017, to reflect the one-year extension of the PTC pursuant to the Tax Increase Prevention Act of 2014. However, unlike the Tax Increase Prevention Act of 2014, which merely extended the sunset date by one year, the Consolidated Appropriations Act of 2016 introduces the phaseout of the PTC. This adds a level of complexity (and thus uncertainty) with respect to any future corresponding extension of such placed-in-service date to reflect the recent extension of the PTC.

As discussed above, under the prior guidance (as extended by IRS Notice 2015-25) the continuity requirement is deemed satisfied if a facility is placed in service before Jan. 1, 2017. In essence, the prior guidance allows a taxpayer two years from the date by which construction must have begun to place the facility in service, irrespective of the date upon which construction actually had begun. Thus, for example, both a facility the construction of which had begun in 2013 and a facility the construction of which had begun in 2014 would satisfy the continuity requirement if they were placed in service prior to Jan. 1, 2017. However, while a uniform placed-in-service date makes sense under prior law, where the amount of the PTC did not vary based on the year in which construction had begun, it is far from certain that the Service will provide a uniform placed-in-service date where the year in which construction begins results in a different credit amount, as is the case under the new act.

As an alternative to a uniform placed-in-service date of prior to Jan. 1, 2022 (assuming that the Service retains the prior guidance's two-year placed-in-service window as discussed below), the Service could introduce a so-called "vintaging" regime that looks at the year in which construction of a facility had begun (i.e., its vintage) to determine the applicable placed-in-service date. Under a "vintaging" regime, a facility will be treated as satisfying the continuity requirement with respect to a particular year only if a facility is placed in service within a specified time period after such year. For example, under this alternative, assuming a two-year placed-in-service window, a project that begins construction in 2017 (i.e., subject to 20 percent reduction) and is placed in service in 2020 would not be deemed to have satisfied the continuity requirement with respect to a claim for the PTC at the 80 percent level, but it would be deemed to have satisfied the continuity requirement with respect to a claim for the PTC at the 60 percent level.

More fundamentally, the Service may decide to revisit whether the prior guidance's "one-size-fits-all" approach that provides a two-year placed-in-service window for all projects is appropriate, or whether a larger project with a longer construction period, for example, may justify a longer placed-in-service window. In this regard, the Service is requesting comments regarding the recent extension of energy tax credits and the impact on the prior guidance and IRS Notice 2015-25, and has informally made known that "everything is on the table."

Thus, while we would expect the Service to generally extend the prior guidance to reflect the extension of the PTC, the Service's apparent willingness to revisit the prior guidance introduces some uncertainty regarding the particulars of any such extension, especially with respect to the placed-in-service date for purposes of the deemed satisfaction of the continuity requirement.

Finally, as discussed above, in addition to extending the time period in which the PTC may be claimed, the act creates parity between the PTC and the ITC by replacing the old "placed-in-service" requirement for the ITC with a "begun construction" standard. Accordingly, under current law, the prior guidance, although by its terms limited to the PTC, would appear, as a matter of policy, to be equally applicable to the ITC. There are, however, certain technical differences between the ITC and the PTC, which may justify modification of the prior guidance in its application to the ITC.

For example, the PTC is available for a "facility,"[12] which, pursuant to IRS guidance, refers to a wind turbine, together with its tower and supporting pad.[13] In contrast, the ITC is available for certain "equipment," which is commonly understood to refer to each individual component comprising a single solar project.[14] Thus, PTC eligibility generally looks toward a single unit (i.e., a turbine), while ITC eligibility looks toward individual components. While this distinction may justify limited modification of the prior guidance in its application to the ITC, particularly as it relates to determining the property on which construction has begun, the broader principles of the prior guidance would appear to be equally applicable to the ITC. Nevertheless, it is not yet clear that the Service will broaden the prior guidance to apply to determining whether construction has begun for purposes of the ITC.

—By Jeffrey G. Davis, Suzanne P. Cartwright, Isaac L. Maron and Binyomin Koff, Mayer Brown LLP

Jeffrey Davis is a partner and Suzanne Cartwright, Isaac Maron and Binyomin Koff are associates in Mayer Brown's Washington, D.C., office.

[1] See Code Section 48(a)(2)(i)(II); P.L. 114-113, Div. P, Title III, Sec. 303.

[2] See Code Section 45(d)(1); Code Section 45(b)(5); P.L. 114-113, Div. P, Title III, Sec. 301.

[3] The IRS has recently solicited certain comments on Notice 2009-52 (providing guidance on the procedures for electing to treat a qualified facility as a qualified investment credit facility), generally regarding the collection of information under the notice. Comments are due by March 7, 2016. See Comment Request for Notice 2009-52, 81 Fed. Reg. 572 (Jan. 6, 2016).

[4] See Code Section 48(a)(5)(E); P.L. 114-113, Div. P, Title III, Sec.302.

[5] See Code Sections 45(d)(2), (3), (4), (6), (7), (9), and (11).

[6] See Code Section 25D (as effective both before and after January 1, 2017); P.L. 114-113, Div. P, Title III, Sec. 304.

[7] See Code Section 168(k); P.L. 114-113, Div. Q, Title I, Sec. 143.

[8] See http://www.epa.gov/cleanpowerplan/clean-power-plan-existing-power-plants.

[9] Prior to the passage of the act, over 580 companies and organizations joined the Business Council for Sustainable Energy in urging Congress to pass the tax credit extensions. Concerted efforts by industry stakeholders could potentially help to improve the odds of congressional support in the future, as could pressure to comply with commitments under the Paris Agreement (the climate change agreement reached at the 2015 United Nations Climate Change Conference). If significant new technologies improving the storage of wind and solar power were to become market-ready, that could be a reason to argue in favor of further extending the credits. Another could be to encourage the construction of off-shore wind farms, which are currently underrepresented in the U.S.

[10] 2013-20 I.R.B. 1085, clarified, I.R.S. Notice 2013-60, 2013-44 I.R.B. 431, clarified and modified, I.R.S. Notice 2014-46, 2014-35 I.R.B. 520.

[11] I.R.S. Notice 2015-25, 2015-13 I.R.B. 814.

[12] See Code Section 45(d)(1).

[13] Rev. Rul. 94-31.

[14] See Code Section 48(a)(3).