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Proposed Solar Bill Highlights Tax Credit Disparities

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On April 21, 2016, Rep. Jared Polis, D-Colo.,[1] introduced in the U.S. House of Representatives the Solar Expansion of Distributed Generation Exponentially Act (the Solar EDGE Act) to provide a two-year increase in the credit available under Section 25D and Section 48 of the Internal Revenue Code for certain solar energy property that has a nameplate capacity of less than 20 kilowatts.[2]

Section 25D of the code provides a tax credit (residential solar tax credit) to individuals for expenditures for property which uses solar energy to generate electricity for use in a dwelling unit located in the United States and used as a residence[3] by the taxpayer (qualified solar electric property expenditures).

Until the recent enactment of the Consolidated Appropriations Act, 2016,[4] Section 25D provided the residential solar tax credit for a taxable year in the amount of 30 percent of the qualified solar electric property expenditures made during such year.[5] Qualified solar electric property expenditures are treated as made when the original installation of the item is completed, or, in the case of an expenditure in connection with construction or reconstruction of a structure, when the original use of the constructed or reconstructed structure by the taxpayer begins.[6] Thus, until the recent enactment of the Consolidated Appropriations Act, a taxpayer would generally be able to claim the 30 percent residential solar tax credit in the year in which the solar electric property was originally installed. The residential solar tax credit was set to expire for property placed in service after Dec. 31, 2016.

The Consolidated Appropriations Act extended the residential solar tax credit for solar electric property that is placed in service before Jan. 1, 2022,[7] but introduced a phase-down based on the specific year in which the solar electric property is placed in service.[8] Property placed in service after Dec. 31, 2016, and before Jan. 1, 2020, is eligible for the full 30 percent credit, whereas property placed in service in 2020 is eligible for only a 26 percent credit and property placed in service in 2021 is eligible for only a 22 percent credit.[9] Thus, in addition to extending and phasing down the residential solar tax credit for solar electric property, the Consolidated Appropriations Act switched to a “place in service” standard to determine the amount of the credit.

It is unclear how this new “placed-in-service” standard is compatible with the residential solar tax credit being allowed in the year in which the qualified solar electric property expenditure is made. As discussed above, Section 25D generally treats the expenditure as made in the year in which the solar electric property is originally installed. The Consolidated Appropriations Act does not appear to change the

determination of when the expenditure is made and thus when the residential solar tax credit is allowed; it simply prescribes the amount of the residential solar tax credit based on the year in which the property is placed in service. Thus, under current law, for property placed in service after 2016, the residential solar tax credit would generally be allowed in the year in which the property is installed, but the amount of the credit would be determined based on the year in which the property is placed in service.

While the year of installation may typically coincide with the year in which the property is treated as placed in service, it is less than certain given the amorphous nature of the placed-in-service determination.[10] For instance, the solar property could be installed in December 2019, but the "permission to operate" from the utility and the necessary local permits could be received in January 2020. If the IRS were to assert that the equipment was not placed in service until 2020,[11] the credit would apparently still be available in 2019 (as that is when "installation [was] completed"[12]); but it would appear the credit amount would be 26 percent (i.e., the amount of the credit for property "placed in service" in 2020[13]) or less if the delays managed to cross another year, not 30 percent (i.e., the amount of the credit for property "placed in service" in 2019).

A more vexing issue would arise if, for example, the solar property was installed in 2020 with the expectation of being placed in service in 2021, but not actually placed in service until January 2022. In this instance, the taxpayer presumably would have been allowed to claim the credit in 2020 based on the expectation of achieving placed-in-service in 2021 (22 percent), even though the tax credit would have ultimately sunset prior to the year in which the property is actually placed in service.[14] However, it would not seem irrational for the IRS to assert that no credit is available to the homeowner as the credit had lapsed by the placed-in-service year. Taxpayers, particularly individuals, should not be asked to tangle with these vagaries while claiming a tax credit for a green investment that the government is attempting to encourage.

The disparate standard for determining the year in which the credit is allowed and the amount and sunset date of such credit could result in a taxpayer being allowed to claim the credit prior to the amount or applicability of the credit being finally determined. A technical fix may be necessary to eliminate this schism and the attendant uncertainty for taxpayers. Our recommendation is for the phase-out rules in Section 25D(g) of the code and the termination date in Section 25D(h) of the code to be amended to refer to "installation" (or "original use of the constructed or reconstructed structure" in the case of construction or reconstruction of a structure) as used in Section 25D(e)(8), rather than the date that property is "placed in service."

As noted above, under current law, the residential solar tax credit is 30 percent of the qualified solar electric property expenditures for property that is placed in service after Dec. 31, 2016, and before Jan. 1, 2020. The Solar EDGE Act would increase the credit to 50 percent for qualified solar electric property expenditures that are made by a taxpayer in 2017 or 2018 with respect to property which has a nameplate capacity of less than 20 kilowatts. Thus, in addition to increasing the amount of the residential solar tax credit, the Solar EDGE Act would revert to the pre-Consolidated Appropriations Act standard of determining the amount of the credit based on the year in which the qualified expenditures are made, rather than the year in which the property is placed in service.

The Solar EDGE Act also seeks to increase the amount of the tax credit under Section 48 of the code. Section 48 of the code provides an investment tax credit (ITC) for equipment deployed in a business which uses solar energy to generate electricity (solar energy property). Under current law, the ITC is 30 percent of the eligible basis of the solar energy property for property the construction of which begins

before Jan. 1, 2020, (provided that the property is placed in service before Jan. 1, 2024).[15] The Solar EDGE Act would increase the ITC to 50 percent for solar energy property that has a nameplate capacity of less than 20 kilowatts and the construction of which begins during 2017 or 2018.

In contrast to the Section 25D tax credit, the amount of the ITC under current law, as well as under the proposed Solar EDGE Act, is determined based on the year in which construction of the property begins, rather than the year in which the property is placed in service. While this so-called "beginning of construction" standard was only recently introduced to the ITC pursuant to the Consolidated Appropriations Act, it has been the deadline point with respect to the production tax credit under Section 45 of the Code.[16]

For purposes of Section 45 of the code, the IRS has issued guidance in the form of a series of notices to clarify when the "beginning of construction" standard would be deemed to have been satisfied.[17] Most recently, in Notice 2016-31, the IRS noted that it would issue separate guidance to address satisfaction of the "beginning of construction" standard for purposes "of the ITC for solar energy facilities." More specifically, on June 21 speaking on a panel at the Renewable Energy Finance Forum in New York, Hannah Hawkins, an attorney-adviser in the Tax Legislative Counsel's office of the U.S. Treasury, said that this solar "beginning of construction" guidance is the next project on our plate," and "we hope to have it out in the fall [or] winter." Enactment of the Solar EDGE Act would further increase the importance of such guidance.

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[1] Polis has a long history of advocating for renewable energy. He introduced legislation similar to the Solar EDGE Act in 2010 to increase the amount of the credit available under Section 25D and Section 48 of code for 2010 and 2011. H.R. 5763, 111th Cong. (2010). He also proposed the Renewable Electricity Standard Act of 2013, which would create a national renewable energy standard under the Public Utility Regulatory Policies Act of 1978 (PURPA) that requires utilities to generate a specified percentage of their electricity from renewable energy sources. H.R. 3654, 113th Cong. (2013).

[2] H.R. 5040, 114th Cong. (2016).

[3] "Residence," for this purpose, includes a principal residence or a dwelling unit used as a second home or a vacation home, but not investment property, such as rental property, that is not also used as residence by the taxpayer. IRS Notice 2013-70, 2013-47 I.R.B. 528.

[4] P.L. 114-113 (2005).

[5] I.R.C. § 25D(a)(1) (effective before Jan. 1, 2017).

[6] I.R.C. § 25D(e)(8).

[7] I.R.C. § 25D(h) (effective Jan. 1, 2017).

[8] I.R.C. § 25D(g) (effective Jan. 1, 2017).

[9] Id.

[10] The placed-in-service determination is generally a fact specific determination that looks at multiple factors. See, e.g., Rev. Rul. 76-256, 1976-2 C.B. 46 (identifying five factors for determining whether a coal-fired electric generating unit is placed in service); Rev. Rul. 84-85, 1984-1 C.B. 10 (applying same factors to solid waste disposal facility that produces energy); Rev. Rul. 79-98, 1979-1 C.B. 103 (applying same factors to nuclear electric generating unit); see also Tax Notes, Salesman Penalized for 'Placed in Service' Interpretation, David Burton, Feb. 17, 2014.

[11] See, Rev. Rul. 76-256, 1976-2 C.B. 46 (identifying five factors for determining whether a coal-fired electric generating unit is placed in service (the closet analogy we have to a solar project for placed-in-service issues), two of which would not be met in this example).

[12] I.R.C. § 25D(e)(8).

[13] I.R.C. § 25D(g)(2) (effective Jan. 1, 2017).

[14] This inconsistency existed in the code prior to the Consolidation Appropriations Act as well, as the sunset date for the residential solar tax credit prior to the Consolidation Appropriations Act was also based on the placed in service date of the solar property, not the year of installation.

[15] I.R.C. §§ 48(a)(2)(A)(i)(II) and (a)(6).

[16] I.R.C. § 45(d).

[17] See I.R.S. Notice 2013-29, 2013-1 C.B. 1082; I.R.S. Notice 2013-60, 2013-2 C.B. 431; I.R.S. Notice 2014-46, 2014-2 C.B. 520; I.R.S. Notice 2015-25, 2015-13 I.R.B. 814; I.R.S. Notice 2016-31, 2016-21 I.R.B. _ (updated in 2016-23 I.R.B. _).