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Maryland's Energy Storage Credit Has Strings Attached

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Law360, New York (June 2, 2017, 11:45 AM EDT) -- On May 4, 2017, Maryland became the first state in the country to offer a tax credit for energy storage systems with Governor Larry Hogan's signing of Senate Bill No. 758 (available here).

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The law provides a tax credit for certain costs of installing an energy storage system. Energy storage systems include systems used to store electrical energy, or mechanical, chemical or thermal energy that was once electrical energy, for use as electrical energy at a later date or in a process that offsets electricity use at peak times. The tax credit is not limited to storage systems that are charged by renewable energy sources.[1]

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The tax credit is up to $5,000 for a system installed on a residential property and the lesser of $75,000 or 30 percent of the cost of the energy storage system for a system installed on a commercial property (which presumably would include a utility). The tax credit would apply to systems installed between Jan. 1, 2018, and Dec. 31, 2022.

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The tax credit may only be used to offset Maryland income tax liability (i.e., it cannot be applied against other types of Maryland taxes such as excise tax) and may not be carried forward to another taxable year. The law sets a limit of $750,000 on the aggregate tax credits issued to all taxpayers in a taxable year, with such credits to be issued on a first-come, first-served basis.

Maryland also recently passed House Bill No. 773, which provides for a study of regulatory reforms and market incentives that may be necessary to increase the use of energy storage devices in Maryland. And the Maryland legislature recently voted to override Hogan's veto of the Clean Energy Jobs bill, which increased Maryland's renewable energy standard to 25 percent by 2020, up from the previous standard of 20 percent by 2022.

The $750,000 aggregate cap on the storage tax credit limits its reach. For example, if commercial projects make up all of the storage systems granted the credit (and each receives the maximum credit), only 10 projects statewide would be eligible for the credit.

Further, the storage tax credit will only be an effective incentive if there are taxpayers with enough Maryland income tax liability in a taxable year to maximize the credit. In this regard, we highlight below two aspects of Maryland tax law (although there are undoubtedly many others) that a project developer may want to consider in determining the value of the storage tax credit.

First, it is not entirely clear whether Maryland would apply the so-called “passive activity credit rules” to an individual that claims the storage tax credit and does not materially participate in the conduct of the related project (for example, a passive investor). Federal income tax law generally limits the amount of losses (so-called “passive activity loss rules”) and business credits (so-called “passive activity credit rules”) allowed to a passive individual investor to the amount of such individual’s tax liability allocable to passive activity.[2]

Maryland law does not expressly incorporate this provision of federal income tax law with respect to tax credits; however, Maryland implicitly adopts the passive activity loss rules by using a taxpayer’s federal taxable income (which is computed taking into account the passive activity loss rules) as the baseline for computing such taxpayer’s Maryland taxable income.[3]

Although the passive activity credit rules are not implicated by this mechanism, Maryland may argue as a matter of policy and parity that credits, like losses, should be subject to the passive activity limitations of federal income tax law.[4] Thus, it’s not clear whether an individual taxpayer would be able to use the storage tax credit to offset all Maryland income tax liability that is not allocable to passive activity.

Second, project sponsors that have insufficient tax appetite to take advantage of a project’s federal income tax credit allowance will often form a partnership with tax equity investors to monetize such credits. However, tax equity investors are frequently unwilling to pay for state tax credits. To maximize the value of both the federal and state tax credits, the tax equity partnership may specially allocate all of the state tax credit to the sponsor (assuming the sponsor has sufficient state taxable income to utilize state tax incentive), while allocating 99 percent of the federal tax attributes to the tax equity investors.

While there is no general provision under Maryland law that would prevent a partnership from specially allocating tax credits in a manner that is disproportionate to the general allocation of profits and losses, a number of existing Maryland tax credits have specific regulatory provisions that would require a partnership to allocate the tax credit in accordance with federal income tax rules.[5]

If Maryland were to issue similar regulations with respect to the storage tax credit, a tax equity partnership may not have the flexibility to specially allocate the storage tax credit in a manner that is inconsistent with the allocation of the federal income tax attributes, thereby reducing the value (and thus the incentive) of the storage tax credit.

While there are a number of practical considerations that may limit the value of Maryland’s storage tax credit, Maryland’s storage tax credit, the first of its kind in the nation, represents a significant step in incentivizing new energy technologies.

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[1] This is in contrast to the federal investment tax credit that only applies to storage if the storage is at least at least 75 percent charged by an investment tax credit eligible power generation project (e.g., a solar project). See, e.g., Treas. Reg. § 1.48-9(d)(3).

[2] See I.R.C. § 469(a)(B).

[3] See Md. Code Ann. Tax-Gen. § 10-203.

[4] In this regard, Maryland provides the comptroller with the general charge to apply the administrative and judicial interpretations of the federal income tax law to the administration of the income tax laws of Maryland. Md. Code Ann. Tax-Gen. § 10-107.

[5] See, e.g., Md. Regs. Code § 24.05.19.11(A) (with respect to the winery and vineyard credit); Md. Regs. Code § 08.02.26.02(B)(2) (with respect to the oyster shell recycling credit).