PUBLICATION

Spotlight on Solar: Tax Credits Available For Businesses

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The solar industry has three sectors that involve solar-electric generating systems, also known as photovoltaic's (PV), such sectors being: (i) residential, in which homeowners install solar equipment on their roofs and in their homes; (ii) commercial; and (iii) utility. The federal government, as well as many state governments, offer incentives in order to encourage the PV industry to develop and achieve economies of scale so that the cost of solar energy will be competitive with other forms of energy. The policies behind such incentives are intended to promote energy independence, high tech job creation and carbon emissions reduction.

This Alert briefly describes the major federal as well as certain state credits that are available to businesses investing in a solar energy system.

Federal

Generally. The federal energy investment tax credit (EITC) under the IRC Section 48 program provides a tax credit to businesses (owners and lessees) equal to 30 percent of eligible project costs (equipment including solar panels, mounts, wiring, and installation, and labor, but not including the cost of any building or structural components), without any cap. To qualify, the equipment must use (a) solar energy to heat or cool a structure, or heat water for use in a structure, or (b) use fiber optics to transmit sun light into a structure.

The EITC is effective when the project is placed in service, and provides the owner that has taxable income with a dollar-for-dollar reduction in federal tax liability, which can be carried back one year and carried forward 20 years. Entities that do not have taxable income can structure the ownership with third party system owners, such as limited liability companies and partnerships, allowing the tax credit to be passed through to third party investors. Any leasing of a solar facility to a tax-exempt entity will cause the facility to be deemed "tax-exempt use property," which is not eligible for EITC.

Many incentives in the form of state rebates, buy-downs, and grants result in taxable income for federal purposes, but do not reduce the eligible product costs used to calculate the EITC. On the other hand, non-taxable rebates from utilities, as well as certain financing provided under an applicable federal, state or local program will reduce the eligible product costs used to calculate the EITC. For example, if the business received a $100,000 nontaxable grant that was spent on the project and the total project costs were $500,000, the adjusted cost basis used to calculate the credit would be $400,000.

The EITC is available for qualifying solar projects placed in service through 2016.

Section 1603 Grant In Lieu Of Credit. Section 1603 of the American Recovery and Reinvestment Act of 2009 allows the taxpayer to receive a cash grant payment directly from the US Treasury in lieu of claiming the 30 percent EITC. Unless extended, the program requires that the solar project must be started before the end of 2011, and placed in service before the end of 2016. The program requires the Treasury to pay the cash grant within 60 days after the completed application is submitted and the project is placed in service. The applicant must submit the grant application to the Treasury Department by September 30, 2012.

Under the Section 1603 program, "commencement of construction" for projects that will not be completed and placed into service by December 31, 2011 is generally deemed to occur when physical work of a significant nature on the project has commenced. Specific rules including a "safe harbor" are provided to help an applicant demonstrate that sufficient work has been performed so as to entitle the applicant to the cash payment upon completion and placement of the project into service.

Payment of the cash grant does not mean that IRS has either determined the project to be eligible or that the Service has approved the tax basis used to calculate the payment. On September 27, 2011, the IRS issued a Memorandum of the Office of Chief Counsel indicating that the Service has the authority to audit and challenge the qualification of the project and the tax basis on which the credit is claimed. The Memorandum states that "excess" grant payments are taxable income in the year received and deductible in the year refunded to the Treasury.

Depreciation. The amount of the EITC or Section 1603 cash grant is not included in taxable income but, the depreciable basis of the solar project is reduced by 50 percent of the amount of the 30 percent EITC or the Section 1603 cash grant, as the case may be. In computing taxable earnings and profits for purposes of determining distributions to shareholders that are taxable dividends, the taxpayer company may compute depreciation on the full cost of the project without regard to the basis reduction for the 30 percent EITC.

Solar projects qualify for accelerated depreciation over five years under the Modified Accelerated Cost Recovery System (MACRS). In addition to MACRS, a solar project placed in service may qualify for 100 percent bonus depreciation of the eligible basis if placed in service between September 8, 2010 and before January 1, 2012, and may qualify for a 50 percent bonus depreciation if placed in service during 2012.

Recapture. EITC compliance covers five years and recapture can apply if there is a change in ownership, or if the use or qualification of the project as an energy facility changes. Under the Section 1603 program, cash grants are subject to recapture over five years if there is a change in use of the facility, the project is terminated, or the project or ownership interest is transferred to a governmental agency or tax exempt entity. The amount of recapture declines by 20 percent each year over the five year period after the facility has been placed in service. For example, the recapture during the first year of service is 100 percent and in the next year it is 80 percent.

Certain States

Alabama. Alabama currently does not provide any tax credits for solar energy systems.

Florida. Florida currently does not provide any tax credits for solar energy systems generally, but does provide a transferrable tax credit for qualifying new solar panel manufacturing facilities that generate at least 400 jobs within six months after commencing operations, and pay an average annual salary for the new jobs of at least $50,000. Florida also exempts certified solar energy systems and components from sales and use tax and provides for property tax exemptions (cost not used to compute property taxes) in specified instances.

Georgia. Businesses are eligible to receive tax credits or a grant (subject to federal tax) of 35 percent of total system cost, up to $500,000 to offset the cost of installing PV generating systems. Homeowners are eligible to receive tax credits or a grant of 35 percent of total system cost, up to $10,500, for solar energy systems. The annual statewide ceiling for aggregate claimed credits is $2.5 million for 2011 and $5 million for each of the years 2012, 2013 and 2014. The tax credits must be taken over four years and to the extent the annual statewide ceiling is reached--with eligible taxpayers having priority on a waiting list over taxpayers who apply for the credits in later years.

Louisiana. A credit is available of up to $25,000 for 50 percent of the costs and installation of the solar energy system. Louisiana also provides for property tax exemptions (value not used to compute property taxes) in specified instances.

Mississippi. Mississippi currently does not provide any tax credits for solar energy systems.

Tennessee. Tennessee offers a number of tax credits and other incentives for solar electric generating systems.

A solar system certified by the Department of Environment and Conservation as a "green energy production facility" will be excluded from the tax base for purposes of calculating the Tennessee business franchise tax (i.e., Tennessee's tax imposed on the net worth of a business with the minimum measure of the tax base being the property owned or used in the State).

Machinery and equipment used in a certified green energy production facility are also eligible for a 100% credit for sales and use taxes paid on that machinery and equipment. In addition, for purposes of the tax imposed by Tennessee local governments on tangible personal property, this machinery and equipment will be taxed at its salvage value, which is deemed to be not more than one-half percent (.5%) of its acquisition value.

A business franchise and excise tax credit equal to 1 percent of the purchase price is also available for solar electric generating systems that qualify as industrial machinery. This credit may be applied to offset up to 50% of a taxpayer's combined franchise and excise tax liability during the year of purchase. Unused credits can be carried forward up to 15 years.

Other franchise and excise tax credits are available to "certified green energy supply chain manufacturers" and their campus affiliates and integrated suppliers and customers. Additional sales and use tax credits are also available to a taxpayer that establishes a qualified facility to support an industry that promotes high-skill, high-wages jobs in clean energy technology. Clean energy technology includes technology used to generate energy from solar sources. These types of credits require substantial levels of capital investment and/or job creation by the taxpayer.

Texas. Texas currently does not provide any tax credits for solar energy systems, but does provide franchise (or margins) tax and property tax incentives. Businesses subject to the Texas franchise tax can deduct 10% of the amortized cost of a solar energy device if certain requirements are met, and businesses engaged solely in the business of manufacturing, selling, or installing solar energy devices can be completely exempt from Texas franchise tax. Texas also provides for property tax exemptions (value not used to compute property taxes) in specified instances.

Conclusion

Tax credits, whether originating with the federal or state governments, can be very instrumental in the start-up and long-term sustainability of a solar venture. Solar tax credits may be combined with certain other tax credits such as new markets credit (IRC Section 45D) or the low income housing credit (IRC Section 42) and with other state and local programs. Should you wish to discuss any aspect of these solar-related tax credits, or any other tax-related issues affecting such ventures, please contact one of the attorneys associated with the Firm's Tax Department.