

The Basics of Solar Tax Credits and Grants

NH&RA 2011

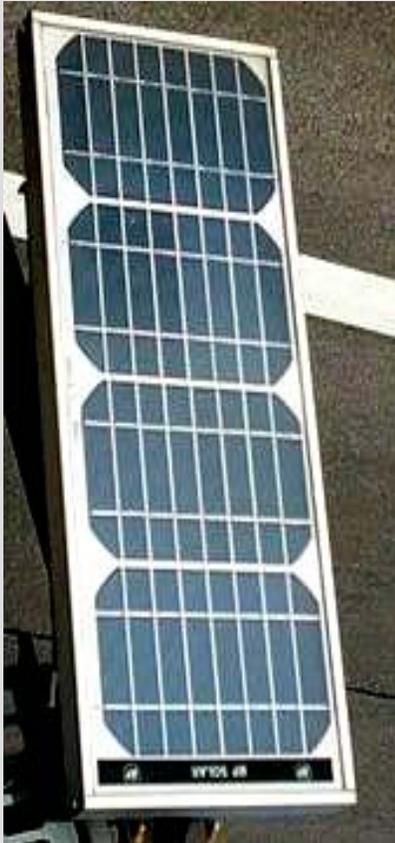
NIXON PEABODY_{LLP}
ATTORNEYS AT LAW

Introduction to Solar Tax Credits

- Solar credit is an investment tax credit (or ITC). It's called an "Energy Tax Credit" in Section 48 of Tax Code.
- Credit is based on cost of facility
- Usually taken all in one year, when the facility is "placed in service"



Overview of Qualifying Property



- Energy Tax Credits are generally 30% of cost of “facility”
- Includes appropriate development fees
- Does not include transmission lines

More on Qualifying Property (cont.)

Other Technologies can also qualify for credits:

- Microturbines (10% credit), fuel cells (30%, but not more than \$3 per watt), combined heat and power (10% credit), “small wind”
- The American Recovery and Reinvestment Act of 2009 (the “2009 Act”) allows a 30% ITC for wind, biomass, solid waste, and a variety of water-generated technologies, with PIS by 2013 (but, 2012 for wind)
- Geothermal that generates electricity gets a 30% credit if PIS by 2013, heat and other electricity gets a 10% credit.

Technical Requirements



- Solar must generate electricity, heating, cooling, hot water, or fiber-optic lighting. (Note: swimming pool rule)
- Must be “new” property: 80% test
- Is a “black box” invoice good enough?

The Tax Benefits and Timing

- Role of “placed in service”, discussed below.

January							February							March						
Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa
		1	2	3	4	5					1	2								1
6	7	8	9	10	11	12	3	4	5	6	7	8	9	2	3	4	5	6	7	8
13	14	15	16	17	18	19	10	11	12	13	14	15	16	9	10	11	12	13	14	15
20	21	22	23	24	25	26	17	18	19	20	21	22	23	16	17	18	19	20	21	22
27	28	29	30	31			24	25	26	27	28	29		23	24	25	26	27	28	29
														30	31					

- Mostly 5-year MACRS depreciation
- But, in 2011, 100% write-off; in 2012, generally 50% write-off

- Recapture is discussed below

Benefits



Need for an Owner

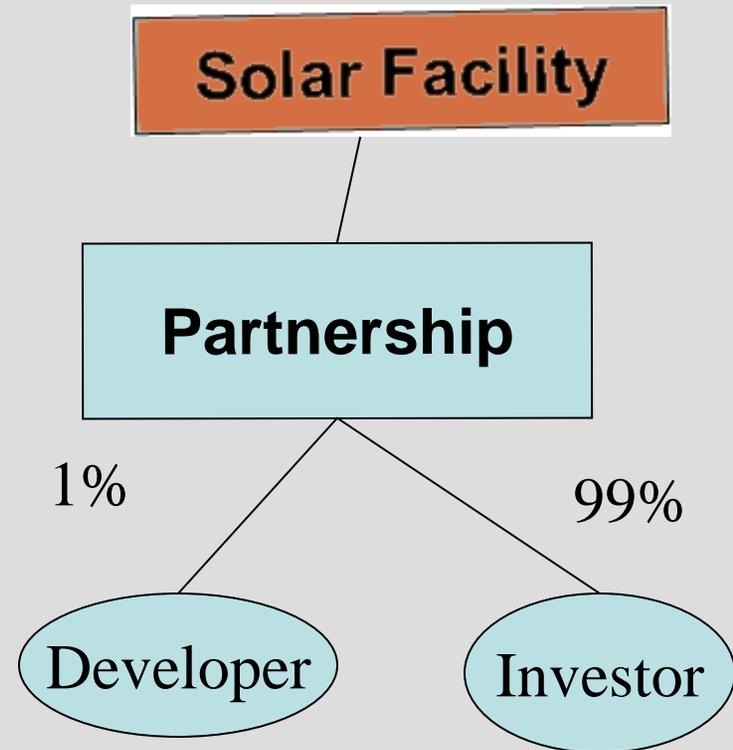
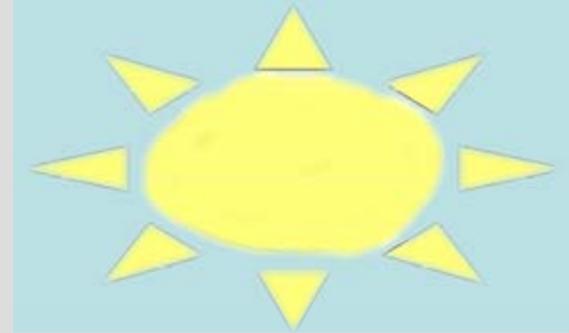
Like housing, there are no “sales” of credits. They are generally claimed by the owner of the facility which makes an “investment” in a partnership or LLC.

Possible structures:

- ♦ Separate Owner who:
 - ♦ sells electricity to housing project
 - ♦ rents panels to housing project
- ♦ Same owner as housing project (which uses the electricity)
- ♦ Fancier Structures (like “lease passthrough”)

Allocations

- Consider whether solar will be owned by housing partnership or a separate owner.
- Regs provide rules for allocating the credits
- Rules are different for ITC and LIHTC
- Role of Wind Rev. Proc. 2007-65
 - Often 99-1 in “pure” energy deals
 - Flips are also common



Doing the Forecast

- Remember that allocations rules are different from LIHTC
- Pricing for credits is often based on IRR vs. cents per dollar of credit
- Depreciation is very different (much faster) and can affect capital accounts. Important to verify that there are no “negative capital account” or “minimum gain” issues.

	A	B	C
1			
2			
3			
4			
5			

Using the Housing Partnership – part 1

Can just make the credits part of the housing partnership, but:

- Big difference between housing that is being built, and housing that is already in the LIHTC credit period – the first may get BOTH credits (if credits are allocated or covered by bonds); the second will generally only get the energy credit.
- Remember that the LIHTC is about 9% times 10 years, or 90%; Even with bonds, it's about 3.5% times 10 or 35%. The energy credit is 30%.
- If solar is intended to also get LIHTCs, then no sale of the energy or lease of the facility, since these are commercial activities

Using the Housing Partnership – part 2

- Note that state may not award additional LIHTCs if they think that the project is getting LIHTC or grants. Bonds work better for this purpose
- Allocation rules are different. This may make fees to GP/operator that are based on profits undesirable.
 - Some tax counsel like caps on cash-flow fees;
 - Others like a fixed amount that carries forward if unpaid

Panels owned by LIHTC Partnership, but Investor Doesn't Pay

- Investor may not have cash set aside to pay for energy credits if they arise later in the deal.
- The panels could be owned by the LIHTC partnership, even if investor won't pay (Energy Credits and Depreciation are then a windfall to investor)
- Allocating the credits panels to the developer/GP is **possible**, but considered terribly complex and undesirable by many
- Grant program (discussed below) may be best way to pay for panels.
- Or have the panels owned by another entity and leased, or sell electricity to the housing partnership

Placed In Service (“PIS”)

- When to start claiming credits – important to make sure that PIS is not before investor admission
- Remember: Placement in Service is not the same as LIHTC
- Typically, date of licenses/permits and pre-operational testing; “Daily operation” can matter
- Sale-leasebacks can buy an extra 90 days, but require a lease structure
- Rules change after 2017, when solar goes back to a 10% credit



Other Subsidies

- Interaction with LIHTC and HTC -- note the 50% basis reduction for the energy credit. Effectively, this reduces the basis for LIHTC and HTC by 15%.
- 1603 Grant program is discussed below.
- Bonds are no longer a problem. They used to come out of basis
- **Important:** State grants can result in income to the recipient (with 99% going to the investor)
- Utility financing and Section 136



Technical Rules

- Corporate vs. Individual Investors; some rules (like “at risk”) are found in the “fine print” from pre-1986 Tax Code
- No AMT for years beginning after October 3, 2008.
- 50% Basis reduction
- Bonus Depreciation, but watch out for special transition rules; note that Congress keeps changing rules
- Profit motive -- Compare Rev. Proc. 2007-65, Reg. 1.42-4, *Sacks* and *Historic Boardwalk Hall* cases.
- Recapture if panels are transferred or destroyed within 5 years after placed in service. 100% recapture in first year, 80% in second, 60%-40%-20%-0 after five years.

Flips, Puts, and Calls

- Once you've gotten the investor **IN**, you need a way to get it **OUT**.
- If LIHTC partnership owns the panels, then the investor will still be in the deal, anyway, so no real need to have a different exit strategy
- With separate owner, we have
 - Flip (from 99-1 to 5-95)
 - Puts
 - Calls



Recap of Structures

- Housing partnership owns it and uses the electricity
- Other owner and lease, with a flip, put, call
- Other owner and PPA with a flip, put, call
- Other owner with a long-term lease (Sale leaseback)
- Other owner with a master tenant and a lease-passthrough

Example: Solar and Housing Credits with Direct Ownership by the Housing Partnership

	Amount of Credits Available	
	9% Housing Credit	“4%” Housing Credit
Solar Panel Cost	\$1,000,000	\$1,000,000
Solar Credit at 30%	\$300,000	\$300,000
Housing Credit Basis <small>(reduced by ½ solar credit)</small>	\$850,000*	\$850,000 *
Credit Percentage <small>(assumed)</small>	9% x 10 = 90%	3.5% x 10 = 35%
Housing Credit	\$765,000	\$324,000
Total Credits	\$1,065,000	\$624,000

*Depreciation is different

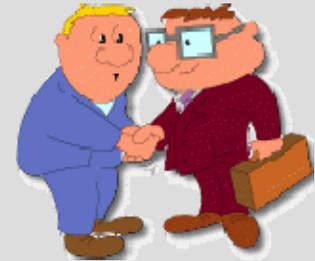
Note that the LIHTC would be a lot higher if there is a 130% DDA or QCT adjuster

Example: What are the credits worth?

- In the previous slide, we had \$1,065,000 of credits if there's a 9% LIHTC, and \$624,000 if there's a 3.5% LIHTC.
- If credits are worth 75¢, then these credits are worth \$795,000 and \$468,000, respectively
- If the Project gets the 130% boost, then the LIHTC goes up by 30%, and total credits go to \$1,288,000, and \$721,000 respectively. At 75¢, then these credits are worth \$966,000 and \$540,000
- There's also more depreciation, and a 50% first year write off if the investor wants it.
- Remember: You need an investor who wants to buy the credits, or you won't get anything for them!



Section 1603 Grant Program



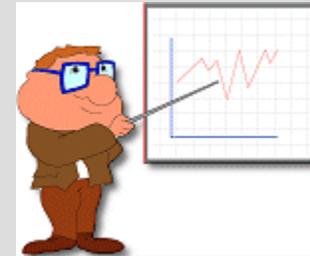
- Added by the 2009 Act.
- Energy facility must be placed in service in 2009, 2010 or 2011, OR begun in 2009, 2010 or 2011 and (for solar) placed in service before January 1, 2017.
- Grant is tax free to the recipient, and it increases the partnership's basis and the partner's basis and capital account, effectively giving free depreciation.

Sec. 1603 Rules (part 1)

- 50% basis reduction (like the energy credit)
- Recapture rules are easier because transfers do not typically cause recapture. Destruction is still a recapture event
- **BUT:** Rules for partnerships with exempt or government partners are *very* complicated
- Must apply, often with CPA's certification, and there's a 60-day wait (or more, if Treasury asks for more info)

Sec. 1603 Rules (part 2)

- Many rules are published, but some are applied by Treasury “behind the curtain”, like the treatment of related-party development fees, or what it thinks is the current “price per watt”.
- The grant is a full 30% (effectively \$1 per dollar of credit) but nothing is paid for depreciation
- May be a need for bridge financing since grant doesn’t arrive till project is placed in service.



Utility Allowance Illustration (part 1)

- Assumptions:
 - Assume total permitted rent is \$1000, and utility allowance is \$75. So, tenants can only be charged \$925 by the landlord
 - Suppose solar panels would reduce utility cost by \$25. So, instead of \$75, we'd expect the actual utility cost to be \$50/mo.

Utility Allowance Illustration (part 2)

- Using \$1000 permitted rent, landlord **should** be able to charge \$950 (because utility allowance **should be** reduced from \$75 to \$50), but 1.42-10 doesn't *require* the utility allowance to take renewables into account. Instead, it may be “stuck” at \$75
- So landlord doesn't get the benefit of the \$25 savings; instead, he still charges \$925, the tenants only pay \$50 for utilities, and their total expenses go down from \$1000 to \$975



Thanks!

**Forrest
Milder**

617-345-1055

fmilder@nixonpeabody.com

13370751

NIXON PEABODY_{LLP}
ATTORNEYS AT LAW