McDermott: United States Renewable Energy Tax Update.

Renewable energy continues to be an active area for tax planning following the legislative extension in late 2014 of the federal tax credits for wind, solar and other renewable projects. Since 2013, there has also been increased interest in the securitization of revenue streams from solar portfolios. Although the future availability of these tax incentives remains uncertain, there are still many tax-planning opportunities in the renewables market for developers and investors.

Impact of 2014 Extenders Bill on Wind Projects

After several failed attempts to enact a two-year extension package, on December 16, 2014, Congress settled on a bill that retroactively extended for one year most of the federal tax code provisions that were otherwise set to expire. The final extenders bill, H.R. 5771, included one-year extensions for the Section 45 production tax credit (PTC) and the Section 48 elective investment tax credit (ITC) for wind and other renewable projects, including biomass, geothermal, solid waste, hydropower, and marine and hydrokinetic renewable energy. Prior to the extension, the PTC and ITC were available to wind projects for which construction had begun prior to January 1, 2014. H.R. 5771 thus gave taxpayers an additional one-year window during which they can satisfy the requirement for beginning construction on wind projects through the end of 2014.

Because this extension occurred so late in the year, it did not provide wind industry participants with much time to begin construction on new projects. Generally, taxpayers can satisfy the beginning of construction requirement by either commencing physical work of a significant nature on the facility (Physical Work Test) or incurring at least 5 percent of the total cost of the facility (Safe Harbor). Thus, taxpayers had just over two weeks to either begin constructing a project or to purchase equipment that could meet the Safe Harbor. Notwithstanding the short timeframe to begin construction, some wind industry participants did enter into turbine supply agreements intended to meet the Safe Harbor in the last week or two of 2014.

One positive consequence of the one-year extension was that it potentially revived projects that had begun construction in 2013 but arguably failed to meet the additional Internal Revenue Service (IRS) requirements of maintaining continuous construction or continuous efforts on the project after 2013. These projects may have encountered delays where it is unclear under the IRS guidance whether or for how long such a delay would be excusable for purposes of satisfying the continuous construction and efforts requirement. With the enactment of the extension, the potential failure to meet the continuous construction and efforts tests in 2014 became moot to the extent progress could be made on those projects by the end of 2014 that satisfied either the Physical Work Test or the Safe Harbor. If those projects could show that they had performed activities by the end of 2014 that would themselves qualify as beginning construction, the clock could restart on the continuous construction and efforts tests in 2015.

While the one-year extension of the ITC and PTC was more helpful to wind and other renewable energy projects than no extension, a longer extension of such credits would have permitted the continued development of projects. Since the ITC and PTC are again expired code provisions for 2015, it seems unlikely that new wind projects will begin construction this year unless such projects have the ability to incorporate equipment that qualified for the Safe Harbor prior to 2015.

Securitizations of Solar Portfolios

Another hot topic in the renewable energy world is the recent securitization of a number of solar portfolios. Since the first securitization of such a portfolio in 2013, solar developers and tax equity investors have shown continued interest in securitizing the revenue streams from host customers (either residential or commercial and industrial) that have solar equipment installed at their homes or sites.

While these securitizations do not necessarily present tax issues, some tax consequences should be considered, such as the potential for recapture of the ITC. The recapture rules broadly provide for recapture of ITCs previously taken if ownership of the solar project changes hands or, in lease transactions where the ITC is passed through to the lessee, the lease is terminated. As a result, any potential securitization generally must retain the original tax equity structure. Nonetheless, there is some flexibility to change the ownership of a lessor in a lease pass-through structure or to change the ownership of a partnership owning solar equipment to the extent no partner transfers more than 33.33 percent of its interest. This is an exciting area likely to see continued growth.

The Renewable Landscape

Unless there is a further extension of the PTC and ITC for wind in the near future, wind projects in 2015 will dwindle without the tax credits to spur new projects. Tax equity investors and other industry participants continue to make investments in solar and other renewable projects, because the ITC for solar, fuel cell, microturbine and geothermal heat pumps, among others, does not expire until January 1, 2017. The potential for extension or modification of the ITC for solar and other renewable energy beyond 2017 remains uncertain.

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