
Renewable Energy: Leveraging the Opportunity Zones Tax Incentive to Improve Returns on Renewables, Storage Plus, and Standalone Storage.

Federal and state tax credits for renewable energy facilities are winding down, but a new federal tax incentive enacted in tax reform may provide a boost to many new installations, repowering projects, and storage facilities. The Qualified Opportunity Zones ("QOZ") incentive provides attractive tax benefits for investors with capital gains that, unlike other federal incentive programs such as the New Markets Tax Credit and Historic Rehabilitation Tax Credit, can be combined with the Investment Tax Credit ("ITC") and Production Tax Credit ("PTC") for facilities located in geographic areas that are designated as QOZ. Further, QOZ benefits will remain in place for a significant period after the ITC and PTC have become less valuable or expired. Recently released regulations provide significant clarity and highlight how valuable the QOZ incentive can be for qualified investments. See our October 23 alert for a discussion of how the regulations make the QOZ incentive even more interesting.

How does the QOZ Incentive work?

The QOZ incentive is designed to encourage long-term investment in over 8700 low-income areas in rural and urban parts of all 50 states, the possessions, and the District of Columbia that have been designated by the Secretary of the Treasury as QOZs. The benefits of the QOZ incentive are available when a taxpayer disposes of a capital asset and, within 180 days, invests the proceeds in a qualified opportunity fund ("QOF") that invests in QOZ property, either through a direct investment in QOZ tangible business property ("QOZBP") or a newly-issued equity interest in a partnership (including an LLC) or corporation operating a business in a QOZ ("QOZB"). A QOF can be a corporation or a partnership (including an LLC) for U.S. federal income tax purposes and can function as an investment fund, a private investment entity, or many options in between. The major requirement is that at least 90 percent of the QOF's assets (measured by cost or value, depending on the applicable facts) must be invested in QOZ property as described above. For more details about the terms and conditions of the QOZ incentives, see our March 14 alert, which contains a helpful overview.

What are the benefits of the QOZ Incentive?

The QOZ incentive consists of three tax benefits for investors.

- First, federal taxes on capital gains invested in QOFs may be deferred until 2026.
- Second, if the taxpayer holds the QOF investment for at least five years, the basis of the asset sold to generate proceeds for investment in the QOF may be increased by 10 percent, thus reducing the capital gain that is eventually recognized. The basis will be increased by another 5 percent if the taxpayer holds the QOF investment for at least seven years.
- Third, if the taxpayer holds the QOF investment for at least 10 years, capital gains realized upon disposition of the investment are free from federal income tax due to a step up in basis of the investment to its fair market value at the time of disposition.

Who can use the QOZ Incentive?

Any U.S. person and certain non-U.S. persons can invest in a QOF and use the QOZ incentive. This includes individuals, corporations, partnerships, and trusts. Partners investing capital gains from a partnership have a longer window to invest in a QOF than the partnership would.

How does the QOZ Incentive help renewables projects?

Many QOZs are located in desirable locations for renewable energy projects and standalone storage. An equity interest in a renewable energy facility (e.g., solar, wind, biomass, geothermal) generally should be a qualified asset, provided that the facility is located in a QOZ and all the requirements of the QOZ incentive for tangible property or a QOZB are met. In addition, there is extensive overlap in the type of property that qualifies for the QOZ incentive, PTC, and ITC, which may boost the value of the ITC and PTC even while the credit rates are sun-setting. Specifically, all three incentives require an ultimate investment in tangible property that is used in a trade or business (ITC and PTC qualified assets also must be personal property). Moreover, the QOZ incentive is:

- technology agnostic;
- available for standalone storage as well as transmission assets;
- available for new installations, as well as repowering or rehabilitation (including installation of storage) of existing installations acquired after December 31, 2017 when expenditure thresholds are met and the work required to meet those thresholds is completed within a 30-month period;
- compatible with the structuring techniques familiar to tax equity investors and developers AND offers new options for tailoring the structure to suit certain investors; and
- may be combined with other available tax credits, including the ITC and PTC.

The benefits of leveraging the QOZ incentive with other tax incentives can be considerable. However, the terms and conditions to meet QOZ requirements are quite complex, so it is important that investors and developers obtain good counsel in order to avoid costly mistakes that could result in loss of QOZ benefits. Our Opportunity Zones and Renewables teams would be happy to help you determine how the QOZ incentive can help your projects pencil out and to make sure you are complying with all QOZ requirements.

Opportunity for Treasury comments/more guidance coming

The U.S. Treasury has requested taxpayer comments on a variety of points in the Proposed Regulations and on several issues to be addressed in forthcoming proposed regulations expected by the end of the year. Taxpayers may provide responses to these requests and other comments through December 28, 2018. Comment opportunities include how long a QOF may take to reinvest proceeds in qualified assets, the treatment of vacant land, how to determine if at least 90 percent of a QOF's assets are qualified assets, how exits must be structured, and when the 30-month period for repowering or other rehabilitation activities of existing projects begins.

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