2018 in Retrospect: The Renewable
Energy Industry in a Post-TCJA World

by Sean Moran, Nicole Gambino, and Lauren Chase

It goes without saying that the last year was an interesting one in the tax world. The Tax Cuts and Jobs Act, signed into law at the end of 2017, made sweeping changes to the U.S. tax code and had a widespread impact on various industries. For better or worse, the TCJA was largely silent regarding the renewable energy industry. But that is not to say that the industry has been isolated from the law’s effects or has been otherwise immune to the uncertainty and the tax challenges presented over the last year or so.

I. Significant Updates in 2018

A. Alta — Challenges to Basis

On July 27, 2018, the Federal Circuit reversed the Court of Federal Claims decision in Alta and held that in the case of renewable energy property sold before the property’s in-service date at a price above the seller’s cost, the basis of property eligible for the 30 percent cash grant available under section 1603 of the American Recovery and Reinvestment Act of 2009 (the section 1603 grant), should be determined under section 1060, and therefore a portion of the basis may be allocable to intangible assets.

We (and many others) have already written about this case. But it is worth reiterating that we believe the circuit court’s determination that the sale of a wind farm is governed by section 1060 is flawed because it assumes that renewable energy offtake agreements have economic value — which is typically not the case. We also think it is a stretch to conclude that the sale of a wind farm is an “applicable asset acquisition” as that term is used in section 1060 because wind farms are not the type of asset to which goodwill or going-concern value attaches. Even if the sale of, or investment

1 Alta Wind I Owner-Lessor C v. United States, 128 Fed. Cl. 702 (2016).
2 At issue in the case were six wind farms developed by an established wind developer (the seller). The seller developed the wind farms and entered into long-term agreements for the sale of the electricity generated by each of the wind farms. Before placing the wind farms in service for income tax purposes, the seller sold the wind farms to the plaintiffs in the case and leased back five of them under long-term net leases while the sixth one was retained by a plaintiff for direct operation.
3 See WSGR Alert, “Federal Circuit Reverses and Remands Alta Wind Case Holding That A Portion of the Asserted Section 1603 Basis May Be Allocable to Intangibles” (July 31, 2018).
in, a wind farm is subject to a section 1060 allocation, we believe any value exceeding the hard construction costs should be allocated to turnkey value.\(^4\)

Regardless of the merits of the decision, the tax equity industry has already started responding to Alta. Specifically, the industry has focused on investment structure (whether through a purchase agreement or contribution agreement) because it seems harder for the government to argue that a contribution structure is an applicable asset acquisition — although this is far from certain. Inverted lease structures may gain popularity for the same reason.

Appraisers will end up bearing a lot of the weight of the Alta decision, as they have been (and we expect will continue to be) asked to include section 1060 allocations when performing their valuation of facilities qualifying for the investment tax credit. Of course, much of the emphasis will be on whether and to what extent a facility has turnkey value. As previously noted, it is not common for renewable intangibles to have much, if any, above-market value, so we anticipate that any value above costs should be easily allocable to turnkey, as opposed to intangible, value.

B. Solar ‘Begun Construction’ Guidance

On June 22, 2018, the IRS issued Notice 2018-59, 2018-28 IRB 196 (the ITC guidance), providing long-awaited direction\(^5\) on the “began construction” requirements for facilities qualifying for the ITC.\(^6\) The notice largely follows the begun construction guidance that the IRS previously issued for energy facilities that qualify for the production tax credit (the PTC guidance).

Like the PTC guidance, the ITC guidance proffers two alternative methods to determine when construction has begun: (1) the physical work test (under which physical work of a significant nature has begun and the taxpayer maintains a continuous program of construction);\(^7\) and (2) the 5 percent safe harbor (under which at least 5 percent of the total cost of energy property has been paid or incurred and the taxpayer makes continuous efforts to advance toward completion of the energy property).\(^8\)

Although the ITC guidance is a welcome clarification of the amended terms of section 48 and allows an additional degree of confidence for developers of ITC-eligible property, there are still questions that must be borne out by the industry.

First, we expect to see larger developers seeking to procure qualifying components before the ITC step-down dates so they can qualify for the safe harbor for multiple projects. As with the PTC, developers will need to comply with the requirements to satisfy the safe harbor. Developers should also be mindful of the pricing, carrying costs, and technical applicability of equipment they procure under the safe harbor method.\(^9\)

Moreover, regarding the physical work method, solar property eligible for the ITC is qualitatively different from wind property eligible for the PTC. For residential solar property in particular it seems impractical for the physical work method to ever be used. Even with commercial- and utility-scale solar projects, the type of work that may qualify is relatively limited (the ITC guidance lists as qualifying physical work only the installation of racks or other structures to which are affixed photovoltaic panels, collectors, or solar cells at a site).

Although the ITC guidance was clarified to fix some inconsistencies regarding the size of transformers that may be taken into account

---

\(^4\) The government’s motivation appears to be result oriented (that is, if it can establish that purchase price exceeds costs, in applying the section 1060 residual method, the excess is considered goodwill or going concern without having to establish the grounds or logic of such treatment).


\(^7\) The physical work test described in the ITC guidance is like that in the PTC guidance because it provides that whether physical work of a significant nature has begun depends on the relevant facts and circumstances and may include work performed by the taxpayer, work performed for the taxpayer by another person under a binding written contract, and work either on site or off site.

\(^8\) Like the PTC guidance, the 5 percent safe harbor in the ITC guidance is determined by reference to the total depreciable basis of energy property, not including the cost of land or any property not integral to the energy property. Moreover, for a single project comprising multiple facilities, the ITC guidance and the PTC guidance each permit a taxpayer to disaggregate some energy facilities that experience cost overruns.

\(^9\) We are aware of developers who are already working to prepare form agreements in anticipation of procuring a significant amount of 100 percent ITC-eligible solar energy property at the end of 2019.
under the safe harbor or physical work methods.\textsuperscript{10} as with the PTC guidance, the IRS may scrutinize the amount of work on a transformer required under the physical work method and whether a transformer is sufficiently integral or custom designed.

C. Partnership Audit Rules

A less exciting, but still comprehensive, change that tax counsel continued to work through in 2018 was the elimination of the 1982 Tax Equity and Fiscal Responsibility Act and enactment of the new centralized partnership audit rules.\textsuperscript{11} Put simply, the new rules provide that IRS audits are now performed at the partnership, as opposed to partner, level.

A description or analysis of the new partnership audit rules is beyond the scope of this article,\textsuperscript{12} but we note that in the renewable tax equity industry it appears that all parties are becoming more comfortable with the section 6226 election, which essentially pushes out any tax liability to the partners of an audited partnership. Although this election is administratively relatively simple and significantly reduces the need to negotiate complicated, lengthy provisions in partnership operating agreements, it is not without cost — the election comes with an additional 2 percent interest charge. Accordingly, it would be prudent to have a backup plan in case the parties determine that they would prefer to forgo the section 6226 election in favor of amending partner-level returns using the pull-in method\textsuperscript{13} or simply paying the tax at the partnership level.

D. Storage Property

Unfortunately, not much can be said about storage property. Although the IRS previously promised guidance on the definition of energy property,\textsuperscript{14} it has not yet been issued (and it’s anyone’s guess when it might be published).\textsuperscript{15}

Therefore, uncertainty regarding whether and to what extent storage property is eligible for the ITC persists.\textsuperscript{16} This uncertainty, however, has not prevented financing of solar-plus-storage projects deemed eligible for the ITC when the facts at hand are relatively straightforward (such as when the storage is installed concurrently with the solar, the solar and storage are owned by the same taxpayer, the storage only stores energy generated by the solar system, or the storage is on the generating side of the meter). We expect this trend to continue even though the hope for guidance is waning.

E. Repowerings

One area in which there were no legislative or judicial changes but that seemed to be a hot topic in 2018 was wind farm repowering. Essentially, a repowering occurs when a taxpayer makes payments for improvements or other capital expenditures so that these expenditures exceed 80 percent of the amount of the expenditures plus the value of the old or existing property — causing the wind farm to be treated as newly placed in service and the 10-year PTC clock to restart.\textsuperscript{17}

The principles of a repowering have been around for some time, and the basic rule is

\textsuperscript{10} After issuance, the ITC guidance was corrected to remove any voltage limitations regarding transformers that were present in the originally issued version. As revised, physical work on a custom-designed transformer that steps up the voltage of electricity produced at an energy property to the voltage needed for transmission will be considered.

\textsuperscript{11} The centralized partnership audit rules were enacted under the Bipartisan Budget Act of 2015 (P.L. 114-74) and are generally effective for tax years beginning after December 31, 2017.

\textsuperscript{12} The rules are still subject to ongoing change and interpretation as regulations are issued and reissued. Most recently, the IRS released final regulations (T.D. 9844) implementing the centralized partnership audit regime. And, as discussed further in this article, various regulations were also issued in 2018 on immediate expensing, the base erosion and antiabuse tax, and the section 163(j) interest limitations rules, among others.

\textsuperscript{13} The pull-in method generally allows partners to pay the tax that would be due with an amended return and make binding changes to their tax attributes for subsequent years, thus reducing the amount of the imputed underpayment due at the partnership level.


\textsuperscript{15} Notably, guidance on the definition of energy property is no longer on the IRS priority guidance plan.

\textsuperscript{16} We understand that there is interest among some groups in lobbying for a storage-specific ITC.

\textsuperscript{17} See Rev. Rul. 94-31, 1994-1 C.B. 16.

\textsuperscript{18} Note that the repowering test is determined on a facility by facility basis.
relatively clear: If the value of the existing property does not exceed 20 percent of the value of that property plus the cost of the repowering, a repowering should occur. However, in practice and as applied to vintage wind farms, things get more complicated.

Not surprisingly, the focus in a repowering is on the appraisal of the existing property. Much could be written about appraisal methods — especially in the repowering context — but we will save that discussion for now and say simply that each appraiser seems to have his own method, preferences, and scope of work, which creates some difficulty and, in some cases, concern.

Moreover, notwithstanding the relatively formulaic repowering rules, questions arise regarding whether the repowering should result in a qualitative improvement in the relevant property. Basic tax doctrines lead us to answer in the affirmative. Again, we will save a detailed discussion of these matters for another day. Given the increasing popularity of repowerings in the wind market, we expect the industry will continue to grapple with these issues.

II. Impact of the TCJA

A. Tax Rates

Perhaps most notably, the TCJA reduced the top corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017. There was initially concern that the lower value of depreciation and reduction in tax capacity because of reduced tax rates could negatively affect the renewable tax equity industry.

Anecdotally, however, we have not seen a notable reduction in the appetite for tax equity. It appears that even with the lower tax rate, there is still a surplus of tax being paid by tax equity investors and plenty of tax capacity available. In our experience, regulatory and internal approvals have been far more constraining than tax capacity. As a result, although the far-reaching effects of the reduced corporate tax rate are hard to predict (and pricing for renewable investments is in a constant state of flux), we do not believe that the reduced corporate tax rate will have a significant chilling effect on the renewable energy industry.\(^\text{19}\)

An additional consequence of the reduced corporate tax rate is that it may affect the choice of entity for renewable developers and other players in the industry. With the corporate tax rate now much lower than the top individual rate (combined with the nondeductibility of state income taxes), the impact of the corporate double tax is far less significant, and therefore companies that would previously have been organized as partnerships to avoid double taxation may decide to incorporate for administrative and organizational simplicity, without a meaningful tax burden (at least as long as the 21 percent tax rate remains intact).

B. Immediate Expensing

After tax rate reduction, one of the most important changes in the TCJA is the extension and modification of the bonus depreciation rules. Under the new law, section 168(k) is amended to increase the previously available 50 percent bonus depreciation to 100 percent bonus depreciation (immediate expensing) for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023,\(^\text{20}\) with a step-down of the percentage of bonus depreciation allowable for property placed in service after 2022 and before January 1, 2027.\(^\text{21}\)

Departing entirely from the previous bonus depreciation rules, the TCJA allows immediate

\(^{19}\)Note also that the lower corporate tax rate will have the positive effect of increasing the after-tax cash flow generated by renewable projects once depreciation has burned off, which can at least partially offset the reduced value of tax benefits.

\(^{20}\)If property was acquired after September 27, 2017, and placed in service in the taxpayer’s first tax year ending after September 27, 2017, the taxpayer can elect to apply the previous percentages of bonus depreciation in lieu of immediate expensing.

\(^{21}\)Section 168(k) (as amended by the TCJA) provides (1) 80 percent bonus depreciation for qualified property placed in service in 2023, (2) 60 percent bonus depreciation for qualified property placed in service in 2024, (3) 40 percent bonus depreciation for qualified property placed in service in 2025, and (4) 20 percent bonus depreciation for qualified property placed in service in 2026. An additional one year for each period is permitted for some qualified property with a longer production period.
expensing for used property in specified circumstances. This has the potential to create additional third-party financing structures for renewable investment. By providing that used property may be eligible for immediate expensing (if the property was not previously used by the taxpayer and the section 179 acquisition requirements are met), developers and investors have a new mechanism for creating tax benefits for property that has already been placed in service — that is, developers and investors can sell a renewable project or their interest in the project after it has been placed in service, and the buyer may be able to take the benefit of immediate expensing. This may help to bolster what has historically been a small market for third-party sales of operating projects and create additional flexibility, especially for tax equity investors that may need to dispose of their interest to comply with regulatory requirements.

Moreover, proposed regulations issued under amended section 168(k) (REG-104397-18) provide that bonus depreciation may be available for immediately expensing for used property in specified circumstances. For these reasons, we do not expect the immediate expensing allowance to have a large impact on tax equity DROs, but rather compound this concern. We have seen various structures that attempt to limit the effect of immediate expensing on tax equity DROs, but they are often complicated and predicated on the assumption that the sponsor can take some portion of the benefit of depreciation deductions. For these reasons, we do not expect the immediate expensing allowance to have a large impact on renewable projects that are financed using tax equity partnerships. However, other structures such as sale leasebacks may be able to benefit from immediate expensing.

C. International Tax Reform

Another area of the tax law that saw sweeping change in 2018 is international tax. Dating back to 1986 and until the TCJA went into effect, the United States taxed multinationals based on their worldwide income and generally taxed the income of non-U.S. subsidiaries when they distributed it to their U.S. parent (with numerous exceptions and deferrals). But under the TCJA, the United States will tax these companies based on a quasi-territorial tax system, modified to currently tax specified non-U.S. operations. Current subpart F is retained to provide full and immediate taxation of some classes of income and subjects two new classes of income (global intangible low-taxed income and foreign-derived intangible income) to immediate taxation at a reduced rate. Meanwhile, existing, untaxed earnings of specified foreign corporations are subject to deemed repatriation and taxation (at a reduced rate). The deemed repatriation tax is essentially 15.5 percent to the extent of offshore cash and cash equivalents and 8 percent

---

22 Under these rules, immediate expensing is only available for property if the original use of the property begins with the taxpayer or if the property is acquired by the taxpayer at any time before the acquisition, and (2) the acquisition meets the requirements of section 179(d)(2)(A), (B), (C), and 179(d)(3) (generally requiring that the acquisition is not made from a related party).

23 Conversely, the proposed regulations deny section 168(k) bonus depreciation for section 734(b) adjustments and section 704(c) remedial allocations.

24 A notable exception to this trend was in response to the looming TCJA. Over the past few years, tax equity investors were willing to accept bonus depreciation to maximize higher tax rates in advance of what was correctly forecast to be a precipitous drop in the corporate tax rate.
otherwise. It can either be paid as part of the taxpayer’s 2017 tax liability or over a period of up to eight years.  

The effect of deemed repatriation has already been well documented. Numerous articles and insider comments on the subject suggest that potential uses of the repatriated cash include, for example, stock buybacks, debt retirement, mergers and acquisitions, increased dividends, employee bonuses, or investment in building and infrastructure expansion. Although most of these uses will not reduce tax liability, investing in renewable projects would provide taxpayers with valuable ITCs and PTCs and therefore taxpayers with a large deemed repatriation liability would be wise to explore the possibility of investing in renewables. Consequently, it is possible that deemed repatriation will provide a benefit to the renewable energy industry by providing an influx of available capital for renewables.

Further, to discourage U.S. companies from making U.S. tax-deductible payments to foreign subsidiaries and other related parties, under the base erosion and antiabuse tax provision of the TCJA, some large companies that make deductible payments to non-U.S. affiliates exceeding specified thresholds are generally subject to an additional 10 percent U.S. tax (5 percent for tax years beginning in 2018) on those payments.  

Early versions of the TCJA passed by the House only permitted the BEAT to be offset by the research credit available under section 41(a). However, as a result of coordinated lobbying and educational efforts by members of the renewable energy community, the final legislative text of the TCJA was modified to allow offset of the BEAT by the research credit and, for tax years beginning before January 1, 2026, the portion of applicable section 38 credits (including ITCs and PTCs) not exceeding 80 percent of the lesser of (1) the amount of the applicable section 38 credit and (2) the BEAT determined without the reduction for these credits.

Put another way, taxpayers subject to BEAT may be subject to a haircut of up to 20 percent on the value of their ITCs and PTCs.

Based on deal flow through 2018, it appears that most traditional tax equity investors believe they can avoid being subject to BEAT and thus will not be subject to a reduction of their applicable section 38 credits (or at minimum can price the risk into their investment). However, whether a taxpayer is subject to BEAT and the magnitude of payments to foreign affiliates is an annual determination, dependent on complicated calculations and equations. In any event, BEAT has been either ignored entirely in renewable deal documents or explicitly carved out of the calculation mechanics for determining whether a tax equity investor has achieved its intended return.

The issue is further complicated because, as stated previously, applicable section 38 credits will not offset BEAT liability for tax years beginning after December 31, 2025. Therefore, taxpayers will need to have a relatively high level of confidence about their future BEAT position to be willing to invest in renewable projects, especially PTC projects. (Because the PTC is earned over a 10-year period, for any PTC period beginning after 2015 there will be a loss of PTCs during the tail end of that period if the BEAT applies.)

That said, imposition of the BEAT may encourage new investment in the renewable energy market because there are only limited types of credits that are available to reduce BEAT liability — namely, ITCs and PTCs (as well as the research credit). So the net effect of the BEAT...
(combined with deemed repatriation) may be an influx of new and different renewable energy investors and more competition from these investors seeking to invest in a limited pool of high-quality projects.

D. Interest Limitations

Section 163(j), as amended by the TCJA, limits the amount of business interest29 that may be deducted by a taxpayer in any given year to the sum of the taxpayer’s business interest income for that tax year, 30 percent of the taxpayer’s adjusted taxable income for the tax year, and the taxpayer’s floor plan financing interest for the tax year (that is, interest paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory acquired).30

A taxpayer will be exempt from the section 163(j) interest limitations if its average annual gross receipts for the three-tax-year period ending with the tax year that precedes the current tax year do not exceed $25 million (the gross receipts test).31 However, even if a taxpayer meets the gross receipts test, it will remain subject to the interest limitation rules if it is a tax shelter. For this purpose, a tax shelter is defined much more broadly than one might expect, which may directly implicate tax equity and other vehicles for holding renewable projects. In particular, a tax shelter includes any partnership or other entity (other than a corporation that is not an S corporation) if more than 35 percent of the losses of the entity during the tax year are allocable to limited partners or limited entrepreneurs (persons who have an interest in an enterprise other than as a limited partner and do not actively participate in the management of the enterprise).32 Tax equity investments seem to fall squarely within this definition of a tax shelter. Tax equity investors typically invest through limited liability companies, do not actively participate in day-to-day management, and are allocated most of the tax losses in years before the flip.

Be that as it may, because tax equity investors do not want anyone ahead of them in the capital stack, it is relatively rare for a tax equity partnership to have company-level or project-level debt. However, if there is partnership-level debt, it is almost certain that the section 163(j) limitations will apply because of the definition of tax shelter and the aggregation rules used in determining whether the gross receipts test is satisfied. The aggregation rules also make it unlikely that large solar and wind developers will be exempt from the section 163(j) interest limitations for projects that are not subject to tax equity investment and for construction period debt, back-leverage, and corporate-level debt of the developer.33 Considering all this, query whether any developers will be enticed to retain renewable projects to take advantage of tax benefits.

E. Prepaid PPAs

The TCJA provides that for accrual-method taxpayers, the all-events test requiring income to be recognized for tax purposes will be met no later than the tax year in which income is taken into account as income on an applicable financial statement (generally an audited financial

---

29. The proposed regulations issued in 2018 provide an expansive definition of interest for this purpose. Under prop. reg. section 1.163(j)-1(b)(20)(iv), “any expense or loss, to the extent deductible, incurred by a taxpayer in a transaction or series of integrated or related transactions in which the taxpayer secures the use of funds for a period of time is treated as interest expense of the taxpayer if such expense or loss is predominantly incurred in consideration of the time value of money.”

30. The section 163(j) limitation applies to all taxpayers, except those trades and businesses listed in section 163(j)(7) (the trade or business of performing services as an employee, any electing real property trade or business, any electing farming business, and public utilities as defined in section 163(j)(7)(A)(4), and specified small businesses).

31. For purposes of the gross receipts test, some taxpayers are aggregated if they are treated as a single employer under section 52(a) or (b) (dealing with commonly controlled businesses) or section 414(m) or (o) (dealing with affiliated service groups) or would be treated as a single employer under those sections if they had employees. Put very simply, corporations will be aggregated with parent (and brother or sister) corporations if there is common ownership of more than 50 percent of vote or value of the corporations, and partnerships will be aggregated if there is common ownership of more than 50 percent of capital or profits interest in the partnerships.

32. A tax shelter also includes a partnership or other entity if a significant purpose of the partnership, entity, plan, or arrangement is the avoidance or evasion of federal income tax. Although undoubtedly tax equity investors seek to reduce their tax burden by investing in renewable projects and taking advantage of tax credits and depreciation deductions, we do not think this rises to the level of “avoidance or evasion” of tax.

33. Of course, if tax equity investors debt-finance their investment, the section 163(j) interest limitations could apply to that indebtedness as well.
statement) or another financial statement under rules specified by Treasury.

If the income is from advance payments, an accrual method taxpayer can make an election to defer recognition of the portion of the advance payment that is not required to be recognized in the year in which it is received (because it is taken into account as revenue in an applicable financial statement) to the next tax year. In other words, section 451, as amended by the TCJA, permits up to a year of deferral for advance payments.

These rules represent a departure from current practice for renewable projects that are subject to prepaid power purchase agreements (prepaid PPAs). Under the prior version of section 451, revenue from prepaid PPAs could usually be recognized as taxable income over the term of the applicable prepaid PPA — thus deferring most of the revenue over an extended period. Under the TCJA, however, only one year of deferral is permitted and therefore the tax benefits of using a prepaid PPA are significantly diminished. It appears that these rules apply to PPAs with a prepaid component that existed before enactment of the TCJA. Accordingly, any taxpayer with a prepaid PPA may be subject to a previously unexpected income tax bill in 2018.

For future prepaid PPAs, of course, one year of deferral is better than no deferral (particularly for renewable projects that typically operate at a loss in early years) and developers and investors would typically prefer cash in hand. So, notwithstanding these changes, prepaid PPAs may continue to be an attractive option in the renewable market.

III. Conclusion

As a general matter, deal flow in 2018 seemed to start out slowly — likely a response to the uncertainty (and possibly the fatigue) created by the TCJA and the 2017 year-end, transaction-closing sprint. Thankfully, this respite did not last long. From our experience, we saw increasingly complex and first-of-their-kind renewable transactions get off the ground and close in 2018. Moreover, we expect this trend to continue through 2019 and beyond — repowerings, begun construction and basis issues, and the ongoing effect of the new tax law will continue to create both opportunities for fruitful renewable deals and challenges for sound tax practice.