

Company of the Month: Are New England property owners taking full advantage of solar tax benefits?

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Investing in solar energy projects provide significant tax benefits that can dramatically increase an investor's rate of return. With solar energy investments becoming a large part of the Mass. landscape, it is critical to understand the tax rules that pertain to a solar investment.

According to a recent report, investors in Mass. installed 237 megawatts of Solar PV in 2013 with the Commonwealth ranking fourth behind only California, Arizona and North Carolina. Over half of these installations were in the fourth quarter, including, approximately 95 megawatts of nonresidential solar.

One of the prime tax benefits from investing in solar is the 30% federal investment tax credit (ITC). This credit is based on the cost basis of the solar property which includes both hard costs (cost of equipment) as well as soft costs (certain legal, management fees, engineering and other professional fees). It is our experience that many investors are unsure of which costs to include in their credit base potentially reducing their credit. In addition to the ITC, solar projects are eligible for depreciation over a five year period using very favorable accelerated rates. Although not as lucrative as the 50% bonus depreciation benefit (which expired on December 31, 2013) this five-year period still remains a short period to recapture equipment costs.

One area that causes confusion for many solar investors is whether they can use both the losses and ITC in the year incurred or whether they are required to carry these benefits to future tax years. There are two tax concepts that may affect a solar owner's ability to claim current tax benefits: the passive loss and the "at risk" tax basis rules. Although a full discussion of these rules is beyond the scope of this article, it is these concepts that are critical in understanding any solar investment.

Under the passive loss rules, a taxpayer can only deduct passive losses against passive income that he generates from other passive investments. Depending on their level of activity in the solar investment, some investors (mainly developers) may be able to circumvent these rules allowing them to offset solar losses against any type of ordinary income, including wage income.

The prototypical solar investor is one that realizes passive income from other investments, e.g., net rental income, or income from businesses where he does not take an active role in management. It is this investor who can take advantage of his solar losses (i.e., excess depreciation and operating expenses over and above electricity sales and SREC income) to offset his passive income. The investor can carry forward any losses not absorbed against passive income to future years.

In addition to losses, a solar investor may be limited in his ability to use ITC. A passive taxpayer can only use ITC against federal tax generated from his net passive income. For example, if a taxpayer has net passive income (passive income exceeding passive losses) of \$100,000 that generates \$35,000 of individual federal tax, he can use ITC up to \$35,000, albeit he may be subject to a reduction in his ITC based on certain other rules.

The "at risk" tax basis rules prevent a taxpayer from deducting losses for which he is not "at risk." A taxpayer is generally "at risk" for money that he invests in a project adjusted up or down for future project tax attributes, including net income or loss, of the solar investment. For example, a taxpayer investing \$100,000 in a solar deal is "at risk" for \$100,000 enabling him to deduct losses up to this amount (as long as he meets the passive rules noted above). An investor also can be "at risk" for project loans that he personally bears the ultimate responsible to repay.

Investing in a solar deal requires not only knowledge of the economics of the deal but a thorough understanding of the tax rules that can easily trap the unwary investor.

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