



### Solar Energy Investment Tax Credits and Grants

#### What Is the Energy Investment Tax Credit Program?

The federal energy investment tax credit (ITC) program, authorized under 26 USC 48 (section 48), encourages the use of renewable energy, including solar energy property that generates electricity, illumination, or solar process heat.<sup>1</sup> The energy ITC program reduces federal income taxes by offering a 30 percent tax credit to owners or long-term lessees for qualified property that meets established performance and quality standards. Through the end of 2011, there is also the option to receive an equivalent cash payment in lieu of the tax credit.<sup>2</sup>

Qualified property includes solar energy equipment as described in the following bullet list, but, generally, does not include buildings or

<sup>1</sup> See 26 USC 48(a)(3)(A), which lists the types of renewable energy that qualify for the energy ITC, including solar, qualified fuel cell property or qualified microturbine property, combined heat and power system property, qualified small wind-energy property, or equipment that uses the ground or ground water as a thermal energy source.

<sup>2</sup> See 26 USC 48(d), which refers to section 1603 of the American Recovery and Reinvestment Act of 2009, as amended, which gives a bank that is eligible to receive the ITC under section 48 the option to elect *instead* to receive a cash payment (a “1603 payment”) from the U.S. Department of the Treasury in an amount equal to the available energy ITC. The 1603 payment program was extended through the end of 2011 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law No. 111-312, December 17, 2010.

structural components.<sup>3</sup> Under section 48, this includes:

- Equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat (an exception is property used to generate energy to heat a swimming pool).
- Equipment that uses solar energy to illuminate the inside of a structure using fiber-optic distributed sunlight.<sup>4</sup>

On October 3, 2008, the Energy Improvement and Extension Act extended the energy ITC for solar projects through December 31, 2016.<sup>5</sup>

This fact sheet covers the Office of the Comptroller of the Currency’s (OCC) understanding of U.S. federal income tax laws and regulations but does not constitute tax advice. Banks should consult their own tax planners for advice about these tax provisions and their applicability to specific transactions as well as the consequences that may apply to their own transactions.

<sup>3</sup> See 26 USC 48(a)(5)(D)(i)(I) and (II).

<sup>4</sup> See 26 USC 48(a)(3)(A)(i and ii).

<sup>5</sup> Division B of the Emergency Economic Stabilization Act of 2008, Public Law No. 110-343, October 3, 2009.

## How Does the Energy ITC Program Work?

Energy ITCs are used to help lower the cost of owning or financing qualified solar properties. Although there are different deal structures that developers and investors use, the most commonly used involve a lease structure.

Typically, an energy ITC facility owner/developer and an investor, such as a bank, establish an entity, ordinarily a limited partnership (LP) or limited liability company (LLC). A bank usually has a substantial, but passive, interest (e.g., 99.99 percent) in the LP/LLC and the facility owner/developer has a de minimis (e.g., 0.01 percent) interest. This LP/LLC ownership structure permits the tax benefit from the energy ITC to pass through to the bank. Any equity infusion by the bank would lower the total amount that is needed to finance construction of the solar energy facility and thus lower the overall financing cost for the project. If a bank is financing the construction of a solar facility, the bank may also choose to lower the interest rate as a tradeoff for the anticipated benefit the bank will receive from the energy ITC.

Investments in the LP/LLC must be made before the solar energy facility is placed in service. The LP/LLC entity earns a tax credit for 30 percent of the eligible construction and equipment costs. Examples of eligible costs are solar panels, mounts, wiring, and installation. The value of the tax credit is earned when the facility is ready and available for its intended use (i.e., placed in service). The investor obtains a dollar-for-dollar reduction in federal tax liability, which can be carried back one year or carried forward 20 years.

When demand for tax credit investments declined in 2008, section 1603 of the American Recovery and Reinvestment Act (ARRA) provided an alternative option to receive an amount equal to the energy ITC as a direct cash payment from the U.S. Department of the Treasury. A section 1603 grant is available for qualifying property that is placed in service during 2009, 2010, or 2011 or for solar projects when construction begins before

December 31, 2011, and the project is placed in service by the end of 2016. Grant applications must be received by the Treasury Department by September 30, 2012.

The cash grant program has proven to be popular with investors, but other considerations should be evaluated before making that election. For example, corporate alternative minimum tax can be reduced by the amount of the energy ITC. In deals involving tax exempt or “non-qualified” participants with *any* direct ownership interest, the tax credit is the appropriate approach because these types of participants are excluded from the cash grant program. Also, the bank must evaluate its projected taxable income. The full value of the energy ITC is earned immediately when a project is placed in service, so the tax credit investor’s ability to absorb the entire amount of the energy ITC in the first year should be analyzed (although unused tax credits can be carried forward for up to 20 years). Therefore, the cash grant program may be more suitable for very large projects.

Also, the risk of recapture is lower under the cash grant program. Cash grants are subject to recapture only if: 1) there is a change in use of the facility in the first five years, 2) the project is shut down, or 3) the project or a partnership interest is transferred to a governmental agency or tax-exempt entity.

The energy ITC compliance period is five years. During the five-year compliance period, recapture of the tax credit can be triggered if either: 1) the property ceases to be a qualified energy facility or 2) a change in ownership interest occurs. To avoid tax credit recapture, the members/partners of the LP/LLC must retain ownership of the property for the five-year compliance period following the year a property is placed in service.

During the first year after the facility has been placed in service, the recapture rate is 100 percent. The rate declines by 20 percent each year thereafter until the end of the fifth year. The recapture period expires at the end of the fifth year after the facility has been placed in service.

A national bank, as a member of an LP or LLC, also may receive additional returns from the pass through of depreciation and cash flows generated by these investments, depending on how the LP/LLC is structured.

Efforts to incorporate green technology and sustainable building features and practices are resulting in energy ITCs being used in combination with projects that include low-income housing tax credits (Internal Revenue Code (IRC) section 42), new markets tax credits (IRC section 45D), historic tax credits (IRC section 1.48-12, CFR 1.48-12), and state or local incentives.

Combining energy ITCs with other federal tax credit programs and state or local incentive programs is a complex process. Banks should consult their own tax and legal advisors about the consequences that may apply to their own transactions.

### **How Can Energy ITCs Benefit a Bank?**

Banks choose to invest in energy ITC facilities for several reasons, including:

- Earning attractive rates of return.
- Expanding business opportunities by offering more attractive financing rates.
- Gaining opportunities to diversify into credit products and services.
- Leveraging other tax credit programs.

#### ***Community Reinvestment Act (CRA)***

Neither the CRA nor the implementing regulations specifically address loans or investments in solar energy facilities.

If the energy ITC facility meets the definition of “community development” as defined in the CRA regulation, however, the loan would receive positive consideration provided the geographic requirements are also met.

In this context “community development” means:

- Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
- Community services targeted to low- or moderate-income individuals;
- Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration’s Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or
- Activities that revitalize or stabilize:
  - Low-or moderate-income geographies;
  - Designated disaster areas; or
  - Distressed or underserved non-metropolitan middle-income geographies designated by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the OCC.

Bankers should consult with their OCC supervisory office to discuss the facts and circumstances of specific energy ITC transactions for which CRA consideration is desired.

#### ***Public Welfare Investments***

Investments in energy ITC facilities (or a fund consisting of several energy ITC facilities) may be eligible investments for national banks under the public welfare investment (PWI) authority.<sup>6</sup> A bank’s investment must be designed primarily to promote the public welfare, such as by providing housing, services, or jobs to qualify under the PWI requirements.

Specifically, a national bank or national bank subsidiary may make an investment directly or indirectly if the investment primarily benefits low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted by a governmental entity for redevelopment, or the investment would receive consideration as a

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<sup>6</sup> See 12 USC 24(Eleventh).

“qualified investment” under 12 CFR 25.23 of the CRA.

Under the PWI authority, national banks may invest in solar energy-producing facilities and use the related tax credits, by taking interests in entities that hold solar energy facilities if the facilities are consistent with the PWI requirements.

Several national banks have received PWI approval for investing in energy ITC facilities financed with solar energy tax credits:

- For example, on July 31, 2008, a national bank received PWI approval for an investment in a fund, established as an LLC. The fund made investments in LLC entities, each of which developed, acquired, installed, and maintained solar energy-producing facilities. The investment in the fund primarily benefited low- and moderate-income individuals and areas. ([The Community Development Investment Letter #2008-1](#), August 2008.)
- Similarly, a national bank received PWI approval for an investment in a fund (the company), established as an LLC, when the purpose of the company was to master lease a solar system project financed by the company. The managing member of the company is a renewable energy utility company that designed, installed, insured, and maintained customized solar systems for industrial, commercial, and municipal enterprises. The bank’s investment primarily benefited low- and moderate-income areas. ([Community Development Investment Letter #2009-1](#), November 2009.)
- In another example, a national bank received PWI approval in May 2009 for an investment in an LLC that installs and operates solar systems on owner-occupied, single- to four-family dwellings that primarily benefited low- and moderate-income areas. ([The Community Development Investment Letter 2009-6](#), December 2009.)

National banks seeking to invest in solar facilities under PWI must either request prior OCC approval or submit an after-the-fact notice to the OCC, depending on the bank’s safety and soundness profile, CRA performance, and the nature of the investment.

### **What Are the Risks to Bank Investors?**

Investors in energy ITC facilities benefit from being able to claim the full amount of the federal tax credits in the year that the facility is placed in service. Should a triggering event occur, however, the potential loss of the tax credit and its recapture by the Internal Revenue Service represent a substantial risk to the bank. A bank should consider the tax planning, compliance, and underwriting (including operational and liquidity risks) of energy ITC investments. Investors also should consider technology and construction risks associated with solar equipment and materials used to build and run the facility.

A bank investor must perform front-end due diligence to ensure satisfaction with the financial capacity, performance, management capacity, and expertise of the project developer and general or managing partner.

For tax years beginning after the enactment of the 2008 Energy Improvement and Extension Act, the energy ITC can be used to offset both regular and alternative minimum tax. To take full advantage of the tax credits under the energy ITC program, a bank should have taxable income projected for the term of the investment.

Banks should consult their own tax advisers about these tax treatments and the consequences that may apply to their own transactions.

### **For More Information**

- [OCC’s Public Welfare Investments Community Developments Fact Sheet](#)
- [Public Welfare Investment \(12 CFR 24\) Resource Directory](#)

- [Investing in Solar Energy Using the Public Welfare Investment Authority](#) (July 2011): This issue highlights the innovative investments national banks have made in solar energy-producing facilities using the public welfare investment authority.
- [OCC's District Community Affairs Officers](#)
- Information about the section ["1603 Program: Payments for Specified Energy Property in Lieu of Tax Credits"](#)
- [DSIRE](#), Database of State Incentives for Renewables & Efficiency, North Carolina State University, NC Solar Center, is a comprehensive source of information on federal, state, local, and utility incentives that promote renewable energy and energy efficiency
- [Energy Improvement and Extension Act 2008](#), Division B, Public Law 110-343, 122 STAT. 3807
- [U.S. Department of Energy's](#) information about federal programs involving solar energy
- [U.S. Energy Information Administration's](#) statistical information and analysis regarding renewable energy, including solar energy