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Renewable Energy

How Nonprofits Can Utilize Renewable Credits for Campus Projects

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Agenda

- Broadly cover the types of renewable technologies eligible for U.S. federal income tax credits;
- Discuss some of the regulatory and non-tax considerations related to renewable energy technology;
- Overview of financing considerations for renewable energy projects, including credit monetization strategies; and
- Cover the nuances of the investment tax credit rules.



Understanding the Opportunities

Inflation Reduction Act of 2022 - Summary

Referred to as the IRA



Aug. 16, 2022
signed into law



728
pages



\$738 billion
in funding



\$499 billion
in new spending
and tax cuts

IRA – Incentive Opportunities



What types of credits can apply?

1

Energy storage technology (e.g., batteries)

2

Combined heat and power property (central utility plant)

3

Solar panels

4

Electrochromic or dynamic tinted glass

5

EVs and EV charging stations

6

Energy efficient buildings

7

Waste energy recovery property

8

Ground or ground water to thermal energy property

Relevant Renewable Energy Credits

- §30C Alternative Fuel Vehicle Refueling Property Credit
- §45 Renewable Electricity Production Tax Credit ‡
- §45Q Carbon Oxide Sequestration Credit
- §45Y Electricity Production Credit‡
- §48 Energy Investment Tax Credit‡
- §48E Clean Electricity Investment Credit ‡

‡ In 2025, generally the existing §48 and §45 credits will be replaced by technology-neutral zero carbon emissions § 45Y Clean Electricity Production Credit and §48E Clean Electricity Investment Credit, which are similar in structure to the existing PTC and ITC

Types of Projects

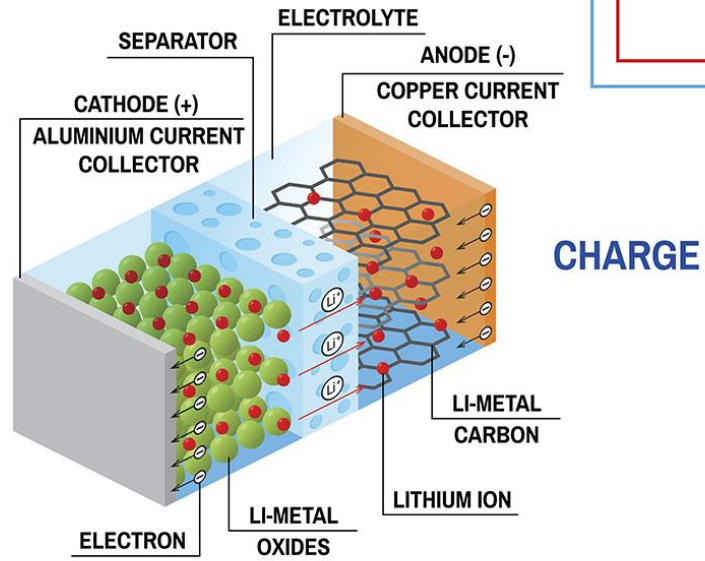
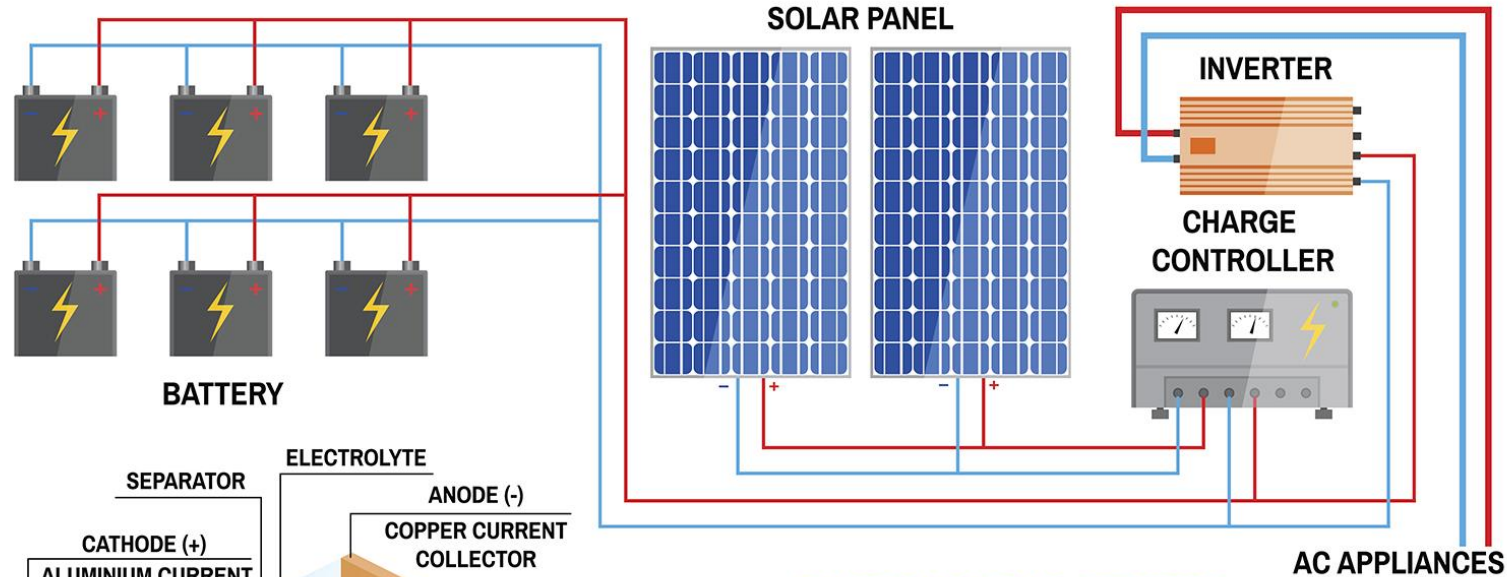
Qualifying Elective Pay-funded Projects

- Solar panel farms or rooftop solar
- Wind farms
- Biomass renewable energy plants
- Geothermal energy projects
- Small irrigation power projects
- Landfill and trash-fueled energy projects
- Hydropower hydrokinetic power plants, including dams
- Battery storage projects
- Electric vehicle charging stations
- Commercial clean vehicles for transportation, facilities maintenance, and other purposes

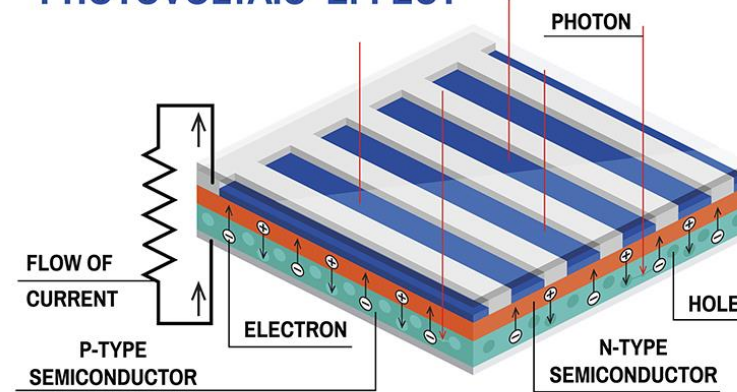
Department of Treasury Examples (Feb. 20, 2024 News Release):

- **Arizona State University:** 90 solar installations powering four campuses, with a total of 24.2 megawatts onsite.
- **University of Georgia:** investments in building efficiency and energy infrastructure through multiple solar arrays and use of steam and chilled water to heat and cool the campus.
- **Pennsylvania State University:** constructing solar farms to supply 25% of school's state-wide electricity needs. As of September 2022, solar arrays have saved Penn State \$2.5 million in energy costs and projected to save more than \$14 million by 2045.

Example: Solar with Battery Storage



PHOTOVOLTAIC EFFECT



Regulatory and Financing Considerations

Regulatory Framework

- **Federal vs. State Regulatory Framework**

- Approval of rates for wholesale sales of electricity and transmission in interstate commerce.
- State PUCs have jurisdiction of construction and maintenance of power generating plants and transmission lines.
- FERC has limited jurisdiction over generation, including registration of Qualifying Facilities (QF) of 1-20 MW.
- U.S./State EPA Permits (air pollution permits).

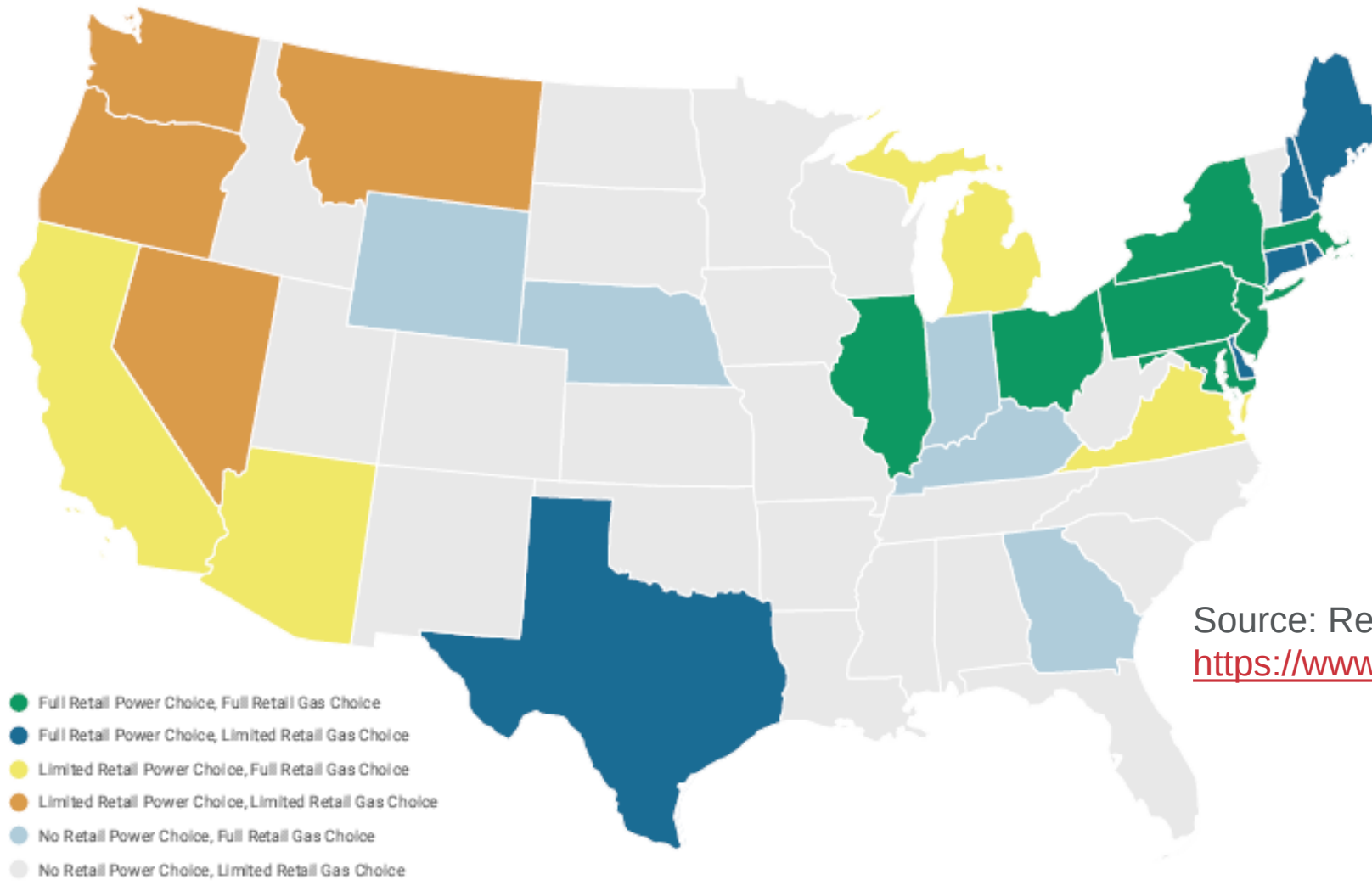


- **FERC QF - PURPA Definitions**

- **Small Power Production Facility:** A small power production facility is a generating facility whose primary energy source is renewable (hydro, wind or solar), biomass, waste, or geothermal resources.
- **Cogeneration Facility:** A cogeneration facility is a generating facility that sequentially produces electricity and another form of useful thermal energy (such as heat or steam) in a way that is more efficient than the separate production of both forms of energy. For example, in addition to the production of electricity, large cogeneration facilities might provide steam for industrial uses in facilities such as paper mills, refineries, or factories, or for HVAC applications in commercial or residential buildings. Smaller cogeneration facilities might provide hot water for domestic heating or other useful applications.

Regulatory Framework

- State Regulatory Framework: Regulated vs. Deregulated Markets



Source: Retail Energy Supply Association - <https://www.resausa.org/energy-by-state/>

Regulatory Framework

- **State and Local Regulatory Considerations:**
 - State Regulatory Issues
 - Definition of “Utility” or “Supplier” under state regulations
 - Certification of facility by state PUC?
 - Utility/Tariff Issues
 - Utility tariff may dictate project parameters
 - Example: Net-metering tariff in FirstEnergy service territory
 - Example: 20 MW Cogeneration plant with geothermal component
 - Local Compliance Issues
 - Local permitting considerations – Example: EV charging stations in California
 - Easements/Rights of Way issues – Example: Microgrid crossing public streets.

Financing

Debt Provider Considerations

- Recourse vs. Non-Recourse
 - Qualifying Commercial Financing
 - Reductions to Basis
- Collateral Package
 - Lien on Project Assets?
 - Pledge of Equity – Borrower/Project Company
 - Construction Debt vs. Term Debt Considerations

Tax Equity Considerations

- Ability to elect direct pay through an entity



Grant Funding

Grants and Forgivable Loans

- Grants and forgivable loans exempt from federal tax
 - Direct pay final regulations provide that grants and forgivable loans made for the specific purpose of funding the acquisition of the energy property **are not** included in the basis of energy property for purposes of calculating applicable credit amount



Monetizing Credits – Direct Pay

- For credits under Sections 30C, 45, 45Y, 48, and 48E, only tax-exempt organizations, state or local governments, Indian tribal governments, Alaska Native Corporations, the Tennessee Valley Authority, and rural electric cooperatives can elect direct pay
 - Entities that are non-profits under state, but not federal, law do not qualify
 - Eligible taxpayer must satisfy the pre-filing and registration process
 - Taxpayer must also make election on original return
 - Eligible taxpayers cannot make a direct pay election when energy property is owned by a partnership
 - What about single-member LLCs?
- Election results in the tax credits being treated as a direct payment from the IRS, similar to a refund
- Payment is made sometime after the filing of return. Is not includable in gross income
 - Lag time

Monetizing Credits – One-Time Transfers

- Eligible taxpayers can transfer one-time an ITC for cash
 - Applies to taxpayers other than tax-exempt organizations, state or local governments, Indian tribal governments, Alaska Native Corporations, the Tennessee Valley Authority, and rural electric cooperatives
 - Can tax-exempts use blocker corporations to elect one-time transfers?
 - Taxpayer has to satisfy the pre-filing and registration process
 - Taxpayer must also make election
- Payment has to be made within the period beginning on the first day of the eligible taxpayer's taxable year during which a specified credit is determined and ending on the due date for completing a transfer election
- Payment is not includable in gross income
- How are payments treated if received by a partnership?

Ins and Outs of Investment Tax Credits

Investment Tax Credit – Energy Property

- Proposed Treasury Regulations were issued on November 17, 2023 defining “energy property”
- Requirements for energy property:
 - Taxpayer must construct, reconstruct, or erect the property, or if the taxpayer is the original user, acquire the property;
 - Depreciable must be “allowable” with respect to the property;
 - Must satisfy certain performance and quality standards;
 - Construction begins before December 31, 2024; and
 - Property is placed in service by the taxpayer.

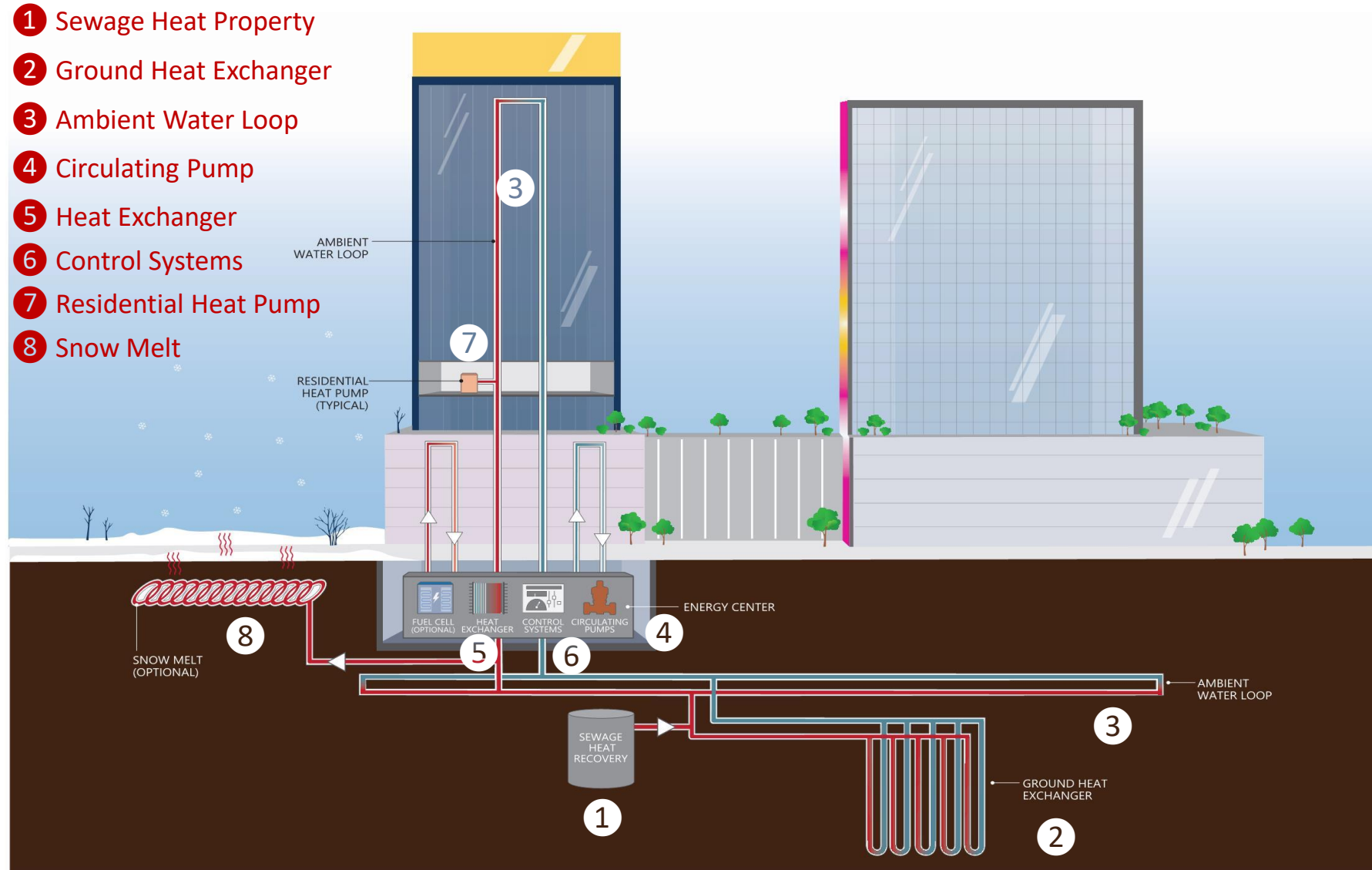
Placed In Service

- ITC is available when energy property is “placed in service” during the taxable year
 - Property is placed in service in the earlier of: (1) taxable year in which, under the taxpayer’s depreciation practice, the period for depreciation with respect to such property begins; or (2) the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function.
- Previously claimed credit by filing IRS Form 3468
 - IRS is amending its forms in time for the 2023 compliance season

Investment Tax Credit – Unit of Energy Property Concept

- Regulations adopt a “unit of energy property concept,” which provides a unit of energy property consists of:
 1. All **functionally interdependent** components of property that operate together and can operate apart from one another, which means that the placing in service of the component is dependent upon the placing in service of each of the other components in order to perform the intended function of the energy property; and
 2. Property that is an **integral part** of the energy property, which means the property is used directly in the intended function of the energy property and is essential to the completeness of the intended function.
- What about dual use property?

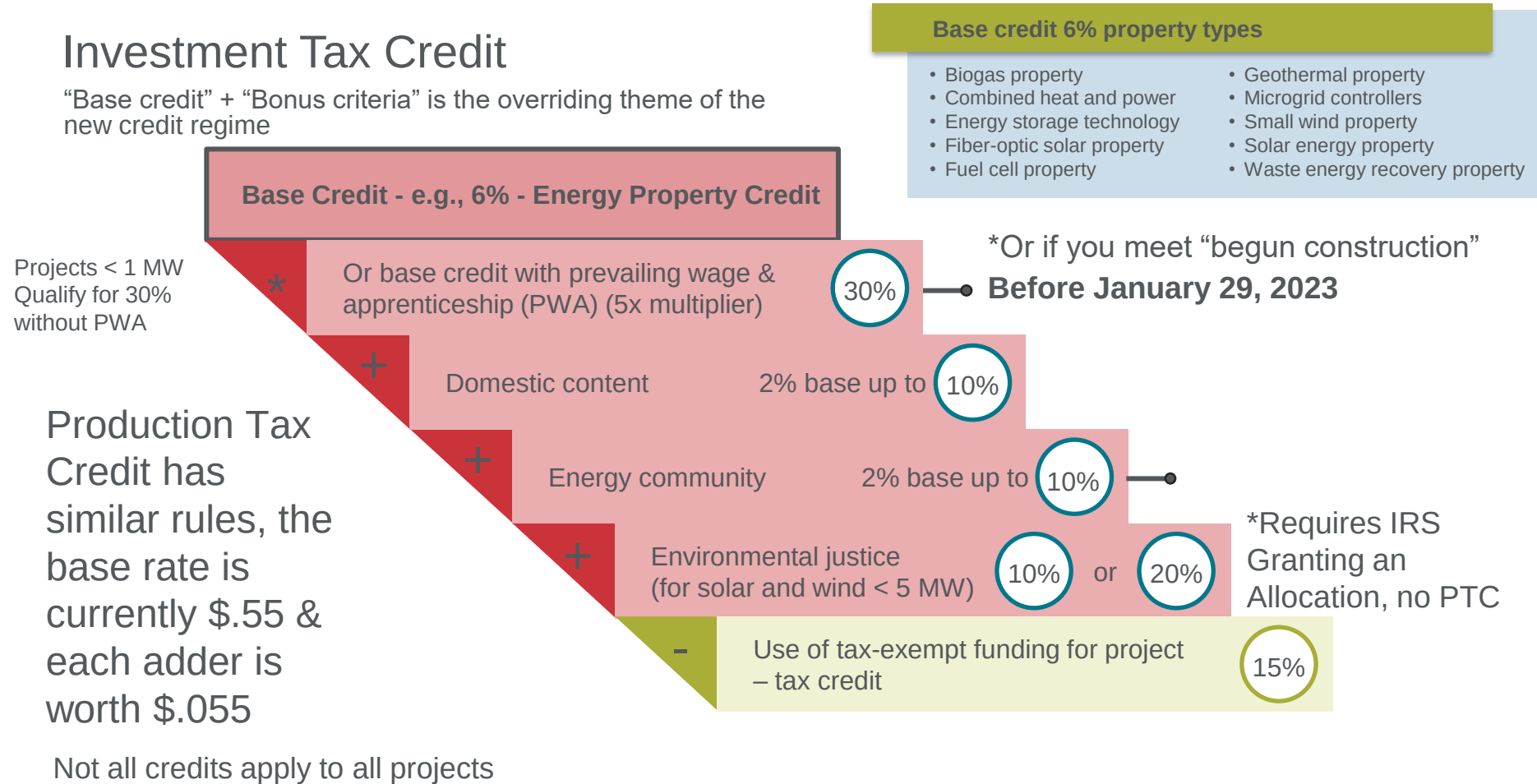
Example – Geothermal Heat Pump



Add-Ons and Bonus Multipliers - Visualization

Investment Tax Credit

“Base credit” + “Bonus criteria” is the overriding theme of the new credit regime



Prevailing Wage and Apprenticeship Requirements



Davis-Bacon wages

Tax credit value reduced substantially if Davis-Bacon wages (i.e., union level wages, as determined by DOL), are not paid during relevant period



Apprenticeship Requirements

Tax credit value reduced substantially if Apprenticeship Rules not followed but Apprentice Rules are avoided if apprentices are not available



< 1 MW AC

Requirements do not apply to projects < 1 megawatts alternating current (MW AC).

For geothermal property, this translates to 3.4 million BTUs/hour for heating and 284 tons for cooling (assessed as either aggregate maximum output of heating and cooling elements or maximum thermal output that the project is capable of delivering)

PWA requirements do not apply for projects that “begin construction” before Jan. 29, 2023

Prevailing Wage and Apprenticeship Requirements

- Prevailing Wages must be paid to labor in connection with:
 - Construction of a project; and
 - Alteration and repair of the project during the relevant credit period
- IRA guidance confirmed the Davis-Bacon definition applies
- Alteration and repairs includes remodeling, renovation, structural repairs, restoration or replacement of fixed components
- Prevailing wages are published by the U.S. Department of Labor for a given locality and job type (available at www.sam.gov)
 - If general determination does not cover a particular job classification, a specific labor determination must be requested
- Have to maintain records demonstrating compliance

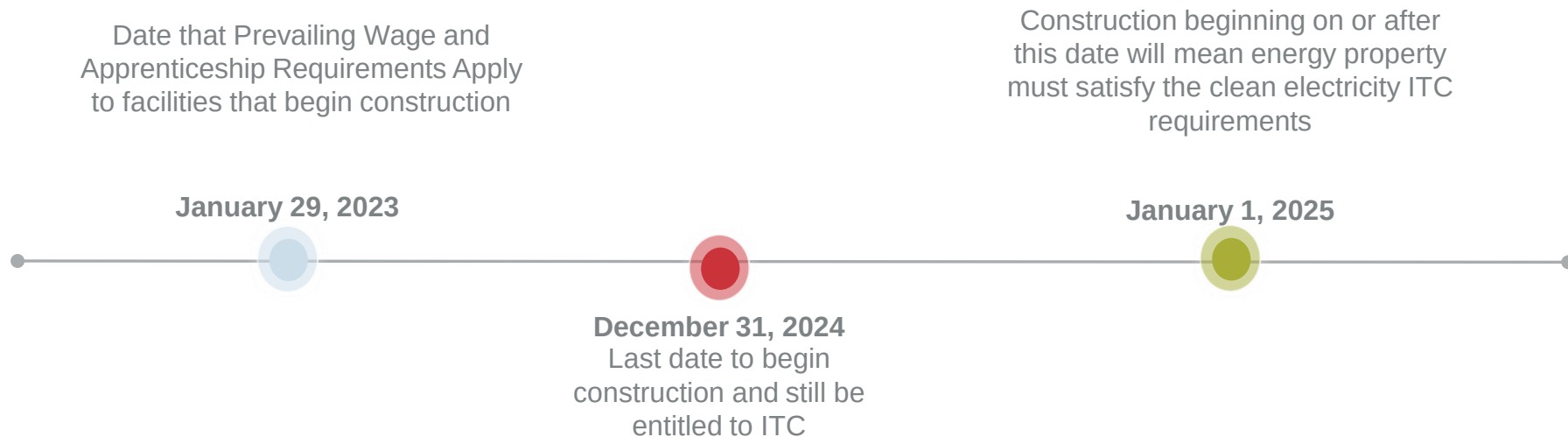
Prevailing Wage and Apprenticeship Requirements (contd.)

- If taxpayer fails to satisfy the prevailing wage requirements, there are cure options
 - Generally must pay to the laborer or mechanic the sum of (1) the difference between the amount required to have been paid to such laborer or mechanic and the amount actually paid and (2) the interest on the difference at the rate of 6% + the federal short-term rate
 - Must also pay a penalty to the IRS equal to \$5,000 multiplied by the number of laborers and mechanics who were paid wages at a rate below the prevailing wage
- Have 180 days after an IRS final determination that the prevailing wage requirements were not met to correct the errors and pay the penalty
- Penalties are waived if work is done pursuant to a pre-hire collective bargaining agreement with one or more labor organizations

Apprenticeship Requirements

- Taxpayer has to ensure that, with respect to facility, qualified apprentices perform no less than the applicable percentage of total labor hours of the project
 - 12.5% for 2023, and 15% for 2024 onward
- Each contractor and subcontract that employs 4 or more individuals to perform construction, alteration, or repair with respect to the construction of the facility must employ one or more qualified apprentice participating in a registered apprenticeship program
 - Must also comply with an apprentice-to-journey worker ratio
 - Set forth by relevant apprenticeship agency
- Good faith effort exception applies if taxpayer requested qualified apprentices and followed up on request
- If apprenticeship requirements are not met, penalty equal to \$50 multiplied by the total labor hours for which the requirement is not satisfied applies
- Penalties are waived if work is done pursuant to a pre-hire collective bargaining agreement with one or more labor organizations

Beginning of Construction Date



The IRS has issued notices that provide guidance for determining when construction begins. The IRS notices describe two methods that a taxpayer may use to establish that construction of a facility begins: (i) by starting physical work of a significant nature (Physical Work Test), and (ii) by paying or incurring five percent or more of the total cost of the facility (Five Percent Safe Harbor).

Recapture

- General rule: ITC is subject to recapture if during the first 5 years after the project is placed in service it is sold or removed from service
 - Recapture percentage declines by 20% a year
 - A foreclosure by a lender is a sale for tax purposes
 - A casualty event that causes the property to be permanently removed from service is also a recapture event
- If the project owner sells the ITC, the ITC buyer suffers the recapture
- If the project owner is a partnership and a partner sells their interest, the partner suffers recapture
 - In tax equity structures, the managing member will often pledge their membership interest for this very reason

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