

## Public Welfare Investments in Solar Energy Facilities Using Renewable Energy Investment Tax Credit

### What Is the Renewable 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.<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 an energy property that meets established performance and quality standards. The amount of the ITC is calculated based on the total cost of a solar energy property, including both equipment and labor but generally does not include the building or structural components on which the equipment is placed. Solar components eligible for the energy ITC would include equipment, such as solar panels, mounts, wiring, and installation.

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<sup>1</sup> Under section 48, energy property 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). See 26 USC 48(a)(3)(A)(i and ii). A variety of types of renewable energy qualify for the energy ITC, including solar, qualified fuel cell property or qualified microturbine property, combined heat and power system property, qualified small solar-energy property, or equipment that uses the ground or ground water as a thermal energy source. See 26 USC 48(a)(2)(A).

The Energy Improvement and Extension Act of 2008 extended the authorization for the energy ITC for solar property.<sup>2</sup> A tax credit investor may use the energy ITC if a solar energy property is placed in service before January 1, 2017.<sup>3</sup>

The full value of the energy ITC is earned immediately when a solar energy property is placed in service. For a five-year compliance period, however, the tax credit is subject to recapture if either (1) the property ceases to be a qualified energy facility, or (2) a change in ownership interest occurs. 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 compliance period expires at the end of the fifth year after the facility has been placed in service.

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<sup>2</sup> Division B of the Emergency Economic Stabilization Act of 2008, Public Law No. 110-343, October 3, 2009. Additionally, section 1603 of the American Recovery and Reinvestment Act (ARRA) provided direct cash payments in lieu of the energy ITC, but that provision has now lapsed. Section 1603 applied to solar projects where construction began before December 31, 2011 and the project is placed in service by the end of 2016. Grant applications must have been received by the Treasury Department by September 30, 2012.

<sup>3</sup> 26 USC 48(a)(2)(A)(i)(II).

National banks (banks) and federal savings associations (FSAs) should consult their tax planners for advice about these tax provisions and the provisions' applicability to specific transactions, as well as the consequences that may apply to their own transactions.

### **How Does the Energy ITC Work?**

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

Typically, an owner/developer and the bank or FSA tax credit investor establish an entity, ordinarily a limited partnership (LP) or limited liability company (LLC). The tax credit investor usually has a substantial, but passive, interest (e.g., 99.99 percent) in the LP/LLC and the owner/developer of the solar energy property 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 tax credit investor.

An equity infusion by the bank or FSA may be used to 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. A bank or FSA that is also financing the construction of a solar energy property, could also choose to lower the interest rate as a tradeoff for the anticipated benefit from the energy ITC.

Investments in the LP/LLC must be made before the solar energy property is placed in service. The LP/LLC entity earns a reduction in federal tax liability for 30 percent of the eligible construction and equipment costs. The value of the tax credit

is earned when the energy property is ready and available for its intended use (i.e., placed in service). The tax credit can be carried back one year or carried forward 20 years. Therefore, the tax credit investor's ability to absorb the entire amount of the energy ITC should be thoroughly analyzed.

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 an energy property is placed in service. For tax years beginning after enactment of the Energy Improvement and Extension Act of 2008, the energy ITC can be used to offset both regular and alternative minimum tax.

A bank or FSA, 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.

Another tax consideration for investments in solar energy equipment is the benefit from the modified accelerated cost recovery system, which provides accelerated depreciation over a five-year period, using the straight-line 20 percent double declining balance depreciation treatment.<sup>4</sup>

A solar energy ITC transaction can be structured in combination with other federal tax credit programs and state or local incentive programs, such as low-income housing tax credits (Internal Revenue Code (IRC) section 42), new markets tax credits (IRC section 45D), or state or local renewable energy incentives, although this is highly complex and requires careful tax planning.

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<sup>4</sup> 26 USC 168.

## What Are the Risks of Energy ITC Investments?

Tax credit investors in solar energy property 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 a tax credit investor. Before making an energy ITC investment a bank or FSA should thoroughly consider the risks, including tax planning, compliance, and underwriting (including operational and liquidity risks.) Banks and FSAs also should consider technology and construction risks associated with solar equipment and materials used to build and run the facility.

A bank or FSA investor must also 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.

To take full advantage of the tax credits under the energy ITC program, a bank or FSA institution should have taxable income projected for the term of the investment.

Banks and FSA institutions 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.

## How Can Energy ITCs Benefit a Bank or FSA?

Banks or FSAs invest in energy ITC transactions 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*

Loans and investments financing “green” buildings, energy-efficiency improvements, wind farms, solar panels, or other renewable energy systems do not in and of themselves qualify for positive consideration under the Community Reinvestment Act (CRA). Neither the CRA nor its implementing regulations specifically address these types of activities. If a loan or investment (activity) has a primary purpose of community development, as defined in the CRA regulation, however, the activity could receive positive CRA consideration, as long as the bank’s or FSA’s geographic requirements also are met.

An activity is considered to possess the requisite primary purpose of community development if a majority of the dollars or beneficiaries of the loan or investment meet one or more of the enumerated community development purposes.<sup>5</sup>

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<sup>5</sup> The CRA regulation at 12 CFR 25.12(g) defines community development as the following:

- (1) Affordable housing (including multifamily rental housing) for low- or moderate-income (LMI) individuals;
- (2) Community services targeted to LMI individuals;
- (3) 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;

Thus, the installation of energy-generating equipment, in and of itself, is not a qualified activity, because this activity does not on its face meet any of the requirements listed above. There are instances, however, where solar energy-related loans or investments could potentially meet the CRA's requirements.

For example, small loans to businesses that manufacture, install, or maintain solar energy generation equipment may receive positive CRA consideration under the review of a bank's retail lending activities, particularly if the loans are made to businesses that have gross annual revenues of \$1 million or less. To the extent that loans to such businesses also meet the definition of community development, examiners may discuss the community development aspects

of the loans in the narrative portion of the bank's CRA public performance evaluation.<sup>6</sup>

Loans used to construct or rehabilitate affordable housing for low- or moderate-income individuals are qualified CRA activities.<sup>7</sup> A construction or rehabilitation project might also include the installation of energy efficient heating and cooling systems or other "green" components. The inclusion of the "green" components in a project that meets the primary purpose of community development would not affect CRA consideration. While examiners are required to evaluate activities based on their primary purpose, they would not give additional consideration for or discount a loan or investment because it also funded a "green" component.

An investment in a manufacturer or installer of solar energy components that located to, or retained its location in, an LMI area where its activities will produce jobs for LMI individuals may qualify for CRA consideration because the activity meets the definition of community development by

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- (4) Activities that revitalize or stabilize:
    - (i) LMI geographies;
    - (ii) Designated disaster areas; or
    - (iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the OCC; or
  - (5) Loans, investments, and services that
    - (i) Support, enable, or facilitate projects or activities that meet the "eligible uses" criteria described in Section 2301(c) of the Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289, 122 Stat. 2654, as amended, and are conducted in designated target areas identified in plans approved by the U.S. Department of Housing and Urban Development in accordance with the Neighborhood Stabilization Program (NSP);
    - (ii) Are provided no later than two years after the last date funds appropriated for NSP are required to be spent by grantees; and
    - (iii) Benefit low-, moderate-, and middle-income individuals and geographies in the bank's assessment area(s) or areas outside the bank's assessment area(s) provided the bank has adequately addressed the community development needs of its assessment areas.

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<sup>6</sup> Intermediate small banks making qualified community development loans to small businesses can opt to have the loans reviewed under the OCC's lending test or the community development test. Large banks making loans qualifying as small business loans as well as community development loans can only report them as small business loans. Intermediate small banks have the option of having small loans to businesses that also meet the definition of community development loans considered under either the lending test or the community development test. For large banks, if a small loan to a business meets the definition of "small business loan" as well as the definition of "community development loan," it may be reported only as a small business loan.

<sup>7</sup> Interagency Questions and Answers Regarding Community Reinvestment" at 75 Fed. Reg. 11645, (March 11, 2010), p. 11648, at \_\_ll.12(h)—1 (at [www.ffiec.gov/cra/pdf/2010-4903.pdf](http://www.ffiec.gov/cra/pdf/2010-4903.pdf)).

helping to revitalize or stabilize the area by creating jobs for LMI individuals and attracting or retaining businesses. The company need not be a small business, because there are no restrictions on business size as it relates to job creation or retention, or on business creation or retention under the definitions of revitalization and stabilization.<sup>8</sup>

Some investments in solar energy facilities are structured to take advantage of more than one type of tax credit. In such a “twinned transaction,” a bank makes two separate equity investments into a single fund—one investment is allocated toward the energy ITC and the other investment is allocated toward a New Markets Tax Credit. The single fund uses the two equity contributions to invest in a community development entity (CDE), which in turn invests in a solar energy manufacturing or installation company that is a qualified active low-income community business. CRA consideration should be available for the entire amount represented by both investments in the single fund once the investment is made in the NMTC-eligible CDE, which is presumed to promote economic development.

Any loan to or investment in a New Markets Tax Credit eligible CDE is presumed to promote economic development and, therefore, should qualify for CRA consideration.<sup>9</sup> In addition, the fact that an investment into an NMTC-eligible entity is structured in a way to take advantage of an additional or different tax credit should not preclude CRA consideration for the full amount(s) invested in the CDE.

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<sup>8</sup> Ibid. p. 11648 at \_\_.12(g)(4)(i)—1, p. 11646 at \_\_.12(g)—2, and p. 11649 \_\_.12(h)—5.

<sup>9</sup> Ibid., p.11646, \_\_.12(g)(3)—1.

Bankers should refer to the “Interagency Questions and Answers Regarding Community Reinvestment” for examples of qualifying community development activities.<sup>10</sup> Bankers also should consult with their OCC supervisory offices to discuss the facts and circumstances of specific activities for which CRA consideration is desired.

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

National banks and FSAs have broad authority to make loans and extend credit.<sup>11</sup> The public welfare investment (PWI) authority permits national bank and FSA investments in solar energy facilities if the investment is “designed primarily to promote the public welfare, including the welfare of low- and moderate-income (LMI) communities or families (such as by providing housing, services, or jobs).<sup>12</sup> FSAs may make investments in a solar energy property under PWI authorities similar to those of banks.”<sup>13</sup>

Solar energy projects do not automatically qualify as PWIs. Federal regulations permit national banks and FSAs to make a PWI if the investment primarily benefits LMI individuals, LMI areas, or other areas

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<sup>10</sup> www.ffiec.gov/cra/pdf/2010-4903.pdf and 75 Fed. Reg. 47 (March 11, 2010), p.11642

<sup>11</sup> 12 USC 24 (Seventh) for national banks and 12 USC 1464(c) for FSAs.

<sup>12</sup> National banks may make investments that are primarily designed to promote the public welfare under the authority found in 12 USC 24 (Eleventh) and the implementing regulation, 12 CFR 24.

<sup>13</sup> FSAs are subject to different investment standards and limits than national banks. The legal authorities for FSAs to make community development investments can be found at 12 CFR 160.36 and 12 CFR 559. See www.occ.gov/pwi.

targeted by a governmental entity for redevelopment, or the investment would receive consideration as a “qualified investment” under 12 CFR 25.23 of the Community Reinvestment Act (CRA) regulations.<sup>14</sup>

Using the PWI authority, national banks and FSAs may invest in a solar energy property, directly or indirectly (i.e., by taking interests in the entities themselves, or in a fund that holds solar energy property), if the beneficiaries or the location of the solar energy property are consistent with the requirements of the PWI authority.<sup>15</sup>

One way to demonstrate benefit to LMI individuals under the PWI authority, for example, is to show a reduction in energy costs in an affordable housing development. Alternatively, the location of a solar energy-property might provide a basis for permitting the investment to qualify as a PWI, because that authority allows national banks and FSAs to invest in projects that primarily benefit LMI areas.

Also, the solar energy property could be located in an area targeted by a governmental entity for redevelopment.<sup>16</sup> Most often, the designation will cover a neighborhood, district, or other geographic

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<sup>14</sup> 12 CFR 24.3.

<sup>15</sup> Examples of investments that qualify under the PWI authority can be found at 12 CFR 24.6.

<sup>16</sup> A national bank or FSA making an investment that relies on these criteria should maintain information documenting that the governmental entity or agency has designated the area; the redevelopment criteria for the area; how the PWI is consistent with the governmental entity’s or agency’s plans; and the type of financing and other support that the governmental entity or agency provides to the area or project in which the investment is made.

area under a formally adopted redevelopment plan that includes special activities and benefits or funding from public and private resources. A governmental entity may include any legally incorporated town, city, county, tribal, or federal governmental agency or entity. Examples of formally designated redevelopment areas include federal empowerment zones, brownfield sites, rural communities, state enterprise zones, or city tax incremental financing (TIF) districts.

The final category involves a “qualified investment” under the CRA regulations.<sup>17</sup> Some investments in solar energy-producing property may be considered qualified investments if the facilities revitalize or stabilize low- or moderate-income areas or rural, middle-income, underserved, or distressed communities.<sup>18</sup> Also, an investment that promotes economic development by financing small businesses may be considered a qualified investment.<sup>19</sup>

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<sup>17</sup> 12 CFR 25.12(t).

<sup>18</sup> See “Interagency Questions and Answers Regarding Community Reinvestment,” 75 Fed. Reg. 11642, 11648, \_\_.12(g)(4)(iii) – 3 and – 4, for more guidance on what is considered to revitalize or stabilize a non-metropolitan, middle-income, distressed, or underserved area. The Interagency Questions and Answers Regarding Community Reinvestment can be found at [www.ffiec.gov/cra/pdf/2010-4903.pdf](http://www.ffiec.gov/cra/pdf/2010-4903.pdf).

<sup>19</sup> 12 CFR 25.12(g)(3). The definition of community development includes 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. See “Interagency Questions and Answers Regarding Community Reinvestment,” 75 Fed. Reg. 11642, 11646, \_\_.12(g)(3) – 1, for guidance on promoting economic development by financing small businesses and farms.

This could include, for example, an investment that finances a small business, where the small business either installs solar turbines or manufactures the turbine's components.

When the location of a solar energy property forms the basis for qualifying under the PWI authority, a national bank or FSA must also demonstrate that there is job creation in order to meet the public welfare standard.<sup>20</sup> For example, if a project is located in an LMI area *and* creates permanent jobs, the institution typically would be able to provide a sufficient basis for establishing the public welfare benefit. For solar energy properties, permanent jobs primarily involve maintenance and servicing.

The Federal Financial Institutions Examination Council's Web site, [www.ffiec.gov/](http://www.ffiec.gov/), can be used to find a list of distressed or underserved census tracts. Median family income statistics and a geocoding system to map census tract level information on area median income can also be found on that Web site, although a specific address is necessary to use the geocoding system. For large solar energy arrays located in rural areas, where an address may be unavailable, other data sources may help pinpoint family or area income by county or census tract. [Policymap.org](http://Policymap.org) is another data source for evaluating area income and includes mapping tools. The U.S. Census Bureau also provides census tract maps by county at [www.census.gov](http://www.census.gov).

Certain safety and soundness considerations and limitations apply to all PWIs. A national bank's aggregate investments under the PWI authority cannot exceed 5 percent of the bank's capital and surplus, although this

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<sup>20</sup> 12 CFR 24.6(b)(3) and (4).

limit may be increased up to 15 percent if the OCC approves a national bank's proposal requesting regulatory permission to exceed the 5 percent limit for its aggregate PWIs.<sup>21</sup>

Investment limits governing these activities for FSAs differ from those for national banks and vary depending on which legal authority is being used to make the investment.<sup>22</sup> In addition, the institution should have the requisite expertise and risk management capabilities to make these investments. Finally, a PWI may never expose a national bank or FSA to unlimited liability.

National banks seeking to invest in solar energy generation facilities under the PWI authority must either submit a prior approval notice to the OCC before making an investment or, if the national bank meets the eligibility standards, submit an after-the-fact notice to the OCC.

Even if an eligible national bank meets the after-the-fact notification requirements, the national bank should consult with the supervisory office to discuss potential legal requirements and safety and soundness issues as well as the OCC Community Affairs Department to discuss whether its proposed investment will qualify as a PWI.

FSAs seeking to make PWIs should comply with the former Office of Thrift Supervision's PWI requirements.<sup>23</sup> FSAs

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<sup>21</sup> 12 CFR 24.4.

<sup>22</sup> 12 CFR 160.36 and 12 CFR 559.

<sup>23</sup> Compliance requirements for FSAs making community development investments can be found at: [www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/federal-savings-association-investment-authorities.html](http://www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/federal-savings-association-investment-authorities.html)

should also consult with the supervisory office before making an investment in a solar energy transaction to discuss potential legal requirements and safety and soundness issues as well as obtain assurances from the OCC regarding the public welfare investment determination.

The OCC has developed a Public Welfare Investments Resource Directory that provides information about the requirements for PWIs and the procedures for filing notices and securing approval from the OCC for an investment.<sup>24</sup>

Several national banks have received PWI approval for investing in solar energy properties financed with energy ITCs:

- 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

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<sup>24</sup> See [www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments.html](http://www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments.html)

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.)

For questions about whether specific investments may qualify as PWIs, or for information on the OCC's approval process for PWIs, contact Karen Bellesi at (202) 649-6420.

## For More Information

- [General Information—Public Welfare Investment](#)
- [Public Welfare Resource Directory](#)
- [National Banks](#)
- [Federal Savings Associations](#)
- [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](#)
- [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. Energy Information Administration](#)  
This site includes statistical information and analysis regarding renewable energy, including solar energy.

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The Tax Cuts and Jobs Act (Pub. L. No. 115-97), signed into law on December 22, 2017, made numerous changes to the Internal Revenue Code. This document has NOT been updated to reflect these changes. Banks or other entities considering a tax credit equity transaction should consult with a tax professional with knowledge of how the changes in the tax code may affect specific tax equity transactions.