Analysis and Ramifications of Hawaii Tax Department Announcement 2012-14

2012 Residential Renewable Energy Systems Will Be Subject to 2013 Tax Credit Announcements Unless Specific Requirements Are Met

Consumers, Contractors, And Tax Practitioners Should Be Familiar With Ramifications of Announcement 2012-14 On 2012-Installed Systems

The Department of Taxation issued temporary administrative rules regarding renewable energy (usually: solar photovoltaic) systems in early November 2012. Initially, the rules were focused on systems installed after January 1, 2013. (I refer to those as "2013 Systems.") There have been numerous news reports regarding these announcements.

On November 16, 2012, the Department issued a further announcement, No. 2012-14, relating to 2012 Systems. According to the 2012-14 Notice, 2012 Systems have to pass an augmented and increased standard to be considered "placed in service." Basically, 2012 Systems are not grandfathered into the 2012 credit regime unless inspection requests are received in 2012 and the system ultimately passes those timely-requested inspection(s).

Failure to meet the requirements of Announcement 2012-14 could have significant consequences as solar industry advocates claim the difference between the 2012 credit regime and the 2013 credit regime will be a 50% reduction in credits, on average.

Turning to the 11/16/2012 Announcement 2012-14, "installed and placed in service" is now defined as follows:

> "Installed and placed in service" means that the system is ready and available for its specific use. With respect to systems installed for residential property, all requirements will be completed and a system will be deemed to be installed and placed in service when: (1) The actual cost has been incurred; (2) all installation, including all related electrical work, has been completed; and (3) any required requests for inspection of the installation has been received by the appropriate government agency. However, if the residential installation fails to pass all the required inspections the credit is properly claimed in the taxable year in which the system passes such inspection.

Broken down, for Announcement 2012-14 purposes, "installed and placed in service" means:

1. The actual cost has been incurred;
2. All installation, including all related electrical work, has been completed;
3. Any required requests for inspection has been received by the appropriate government agency in the taxable year in which the credit is claimed; and,

4. The system passes the requested inspection(s).

If the system fails the inspection, then the system will only be "installed and placed in service" in the year it ultimately passes inspection. See, Announcement 2012-14.

Hawaii Revised Statutes Section 235-12.5, "Renewable Energy Technologies; Income Tax Credit" only requires that the systems are installed and placed in service during the taxable year for which the credit is claimed. See, 235-12.5(a), (g), & (k). Section 235-12.5 provides rule-making powers to the Director of the Department of Taxation "to effectuate the purposes of this section."

The Department's "re-definition" of "installed and placed in service" to include passing inspection is a departure from the usual use of "installed and placed in service" in the tax contexts of depreciation and alternative energy credits. Depreciation is a well-worn tax subject. Usually, installed and placed in service means "ready and available for use." See, IRS Publication 946 (page 7). The conclusion that property is placed in service is bolstered by the active production of income, a situation strongly analogous to a photo-voltaic system actively producing energy for the residence upon which it is installed. While there are reported cases where the approval of required licenses or permits is *a factor* in determining a "placed in service" date (see, *Oglethorpe Power Corp. v. Commissioner*, 60 T.C.M. 850 (1990) and *Sealy Power, Ltd. v. Commissioner*, 46 F.3d 382 (5th Circuit 1995)), the Department's announcement appears to be an abrupt departure from a well-traveled path. At this point, there is no way to know when and whether the Department's rule-making will face or withstand judicial review.

Looking ahead, under Announcement 2012-14, a large system installed in December 2012 could fail an inspection in February 2013 and be subject to the 2013 rules. The 2013 rules are significantly more restrictive than current practice: some solar industry advocates have stated that the average reduction in credits will be 50%.

Consumers.

There is nothing in Notice 2012-14 that "grandfathers" systems installed before its issuance on November 16, 2012, so all 2012 Systems, if they do not meet the "installed and in service" definition, could become 2013 Systems. Purchasers of solar systems installed in 2012 (that have not already passed inspection) should make sure that all appropriate inspections have been requested and the requests received by permitting agencies before the end of the year. Follow-up requests should be made for an inspections not closed. Notice 2012-14 states that the inspection request must be "**received**" – not merely sent. Oahu projects can be checked on-line via the City & County Department of Planning & Permitting.

Contractors.

Contractors will be under pressure to complete 2012 Systems that meet the "installed and placed in service" definition, as the consequences of a failed inspection that results in a new request (after December 31, 2012) could be the loss of substantial state tax credits. Solar companies are marketing their work and systems in part based upon the receipt of tax benefits.

Return Preparers And Tax Practitioners.

Many return preparers are familiar with federal and state renewable energy equipment tax credits and the recent expansion of the "green energy" industry. Many practitioners are familiar with the practice of marketing photo-voltaic "systems" in a manner calculated to meet the credit requirements of HRS 235-12.5 and the controversy surrounding this practice. The Hawaii Legislature considered additional legislation during the 2012 session but ultimately did not enact any legislation. Whether future legislative sessions will revise section 235-12.5 is a guess at this point.

For 2012 Systems, return preparers should anticipate a potential audit situation for systems that fail to meet the requirements of Notice 2012-14. To determine whether an inspection request was received and whether a system passed inspection will be far easier for the Department of Taxation than determining whether the system was actually installed and in service at a certain point in time. Inspections are conducted by a third-party and are a matter of public record; installation is a matter between the taxpayer, contractor, and to a greatly lesser extent the public utility.

Return preparers should consider that the Department of Taxation will revise Form N-342/342A to require a statement of the date(s) that the system(s) passed inspection.

Return preparers and practitioners should be aware that as currently written, HRS 235-12.5(f) states that:

> All claims for the tax credit under this section, including amended claims, shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with this subsection shall constitute a waiver of the right to claim the credit.

This provision creates a problematic situation for a credit later determined to have been claimed in the incorrect year. Because of the usual delay between filing and potential audit, a taxpayer could have a credit disallowed in the filed year and be ineligible under subsection (f) to claim the credit in the following year due to the passage of time. See, for example, *Cosmo World of Hawaii, Inc. v. Okamura*, 36 P.3d 814, 821-822 (ICA 2001).

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