STATE OF ARIZONA
Department of Revenue

Janice K. Brewer
Governor

John A. Greene
Director

March 13, 2013

Attached please find a proposed Arizona Corporate Income Tax Ruling addressing how leases and power purchase agreements impact the commercial solar energy credit under Arizona Revised Statutes (A.R.S.) § 43-1164. The Department would appreciate written comments on this draft ruling.

The deadline for comments is **Monday, April 22, 2013**. Any request for an extension of time for review must also be made by this date. This office will review all comments that are received through this date and make any appropriate revisions before the Department issues the final document.

Please address your comments to:

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ARIZONA CORPORATE INCOME TAX RULING
CTR 13-X

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

Issue:

How do leases and power purchase agreements (PPA) impact the commercial solar energy credit?

Applicable Law:

Arizona Revised Statutes (A.R.S.) § 43-1164 generally, provides a commercial solar energy credit, for corporations and corporate business co-owners, for the installation of solar energy devices during the taxable year, for commercial, industrial or any other nonresidential application in the taxpayer's facility located in Arizona. This section further provides that the credit is equal to 10% of the installed cost of the device, subject to a cumulative maximum of $25,000 per building per year and subject to an overall limitation of $50,000 per year.

A.R.S. § 43-1164(A)(2) provides that the taxpayer who is the third party organization that financed, installed or manufactured the solar energy device, may claim the credit, if the taxpayer or a tax exempt entity, who would otherwise qualify for the credit transfers the credit to the third party organization.

Conclusion:

Following is a list of various questions and answers with respect to how a lease or a PPA impact the commercial solar credit.

Questions and Answers

1. Can a taxpayer that leases a solar energy device that is installed on the taxpayer's business claim the credit?

   If the lease was structured as a **capital lease**, the taxpayer would qualify for the credit. When the lease is a capital lease (an agreement providing that the lessee

has acquired, or will acquire, title to or an equity in the property and is in reality a conditional sales contract) then the lessee would be considered the owner of the solar energy property on the day the property was placed in service. In this case, the lessee would be eligible to claim the credit, if all other conditions were met, since the lessee would have incurred a cost of the device.

If the lease was structured as an **operating lease**, the taxpayer would not qualify for the credit. When the lease is an operating lease, the lessee does not own the solar property on the date the property was placed in service. Therefore, the lessee would not have incurred any costs of the device. In this case, the lessee would not be eligible to claim the credit since the person's cost would be zero.

2. <u>If the lessee cannot claim the credit, can the lessor claim the credit as the owner of the solar energy device?</u>

   No. The credit is available to only the taxpayer who has the solar property installed for a commercial, industrial or other non-residential application on its Arizona property. Even though the lessor would be the owner of the solar property, the lessor would not be eligible to claim the credit since the solar property was not installed on the lessor's commercial, industrial or other non-residential facility. Therefore, in the case of an operating lease, no credit would be allowed to either the taxpayer or to the third party property owner (lessor).

3. <u>If the business has a solar energy device installed and pays for the installation but leases the solar energy device from the manufacturer, can the taxpayer transfer the credit to the manufacturer and can the manufacturer include its cost for the device in the computation of the credit?</u>

   In order for a taxpayer to transfer the credit to a third party, the taxpayer must first qualify for the credit itself. In the case of an operating lease, the taxpayer would not qualify for any credit since the taxpayer would not have incurred any cost of the device. Therefore, the taxpayer could not transfer any credit to a third party. The amount paid for installation would be deemed as part of the lease down payment, which would merely be factored in, when determining the amount of monthly lease payments. Additionally, the manufacturer could not claim a credit based on its cost for the solar device.

4. <u>If a taxpayer enters into a contract where the solar energy device is provided and installed at no charge and the taxpayer only pays for electricity used (PPA), does the taxpayer qualify for a credit?</u>

   No. A PPA is a contract to buy solar power based on a set rate that is usually equal to or less than market rate from the consumer's local utility company. Because the solar electric rate is locked in, the consumer can protect itself from the volatility of

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future utility rate increases. Generally, a PPA customer only pays for solar power, but not the solar equipment or installation. The third party PPA administrator is the party that owns the solar property and that is the party that has incurred all of the costs of the solar property. Therefore, the taxpayer upon whose property the solar equipment was installed would not be eligible to claim the credit since this taxpayer's cost of the device would be zero.

5. <u>If a taxpayer enters into a PPA and pays for the installation of the solar energy device, does the taxpayer qualify for a credit?</u>

   No. There would be no cost incurred by the taxpayer for the device because the taxpayer does not own the solar property. The third party PPA administrator is the party that owns the solar property and that is the party that has incurred all of the costs of the solar property. Therefore, the taxpayer upon whose property the solar equipment was installed would not be eligible to claim the credit since this taxpayer's cost of the device would be zero.

6. <u>If the taxpayer who buys the power through the PPA cannot claim the credit, can the third party solar property owner (PPA administrator) claim the credit as the owner of the solar energy device?</u>

   No. The credit is available to only the taxpayer who has the solar property installed for a commercial, industrial or other non-residential application on its Arizona property. Even though the third party PPA administrator would be the owner of the solar property, the third party PPA administrator would not be eligible to claim the credit since the solar property was not installed on the PPA administrator's commercial, industrial or other non-residential property. Therefore, in the case of a PPA, no credit would be allowed to either the taxpayer or to the third party PPA administrator.

7. <u>If the business enters into a PPA and has a solar energy device installed for free, can the taxpayer transfer the credit to the manufacturer and can the manufacturer include its cost for the device in the computation of the credit?</u>

   No. In order for a taxpayer to transfer the credit to a third party, the taxpayer must first qualify for the credit itself. In the case of a PPA, the taxpayer would not qualify for any credit since the taxpayer would not have incurred any cost of the device. Therefore, the taxpayer could not transfer any credit to a third party. Additionally, the manufacturer could not claim a credit based on its cost for the solar device.

8. <u>If a third party pays for the solar device or its installation can the taxpayer include the amount paid by the third party in the taxpayer's cost used to compute the credit?</u>

   No. If a third party pays for the solar device or its installation the taxpayer would not have incurred a cost of the device for amounts paid by the third party. The third

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party would be the party who incurred the costs. Therefore, a taxpayer could not claim a credit for amounts paid by a third party, since the amounts paid by the third party would not be costs incurred by the taxpayer.

9. <u>If the credit is transferred, is the credit determined before or after the transfer.</u>

   The credit would have to be determined before the transfer. The taxpayer eligible for the credit would have to determine the credit amount before the credit could be transferred.

10. <u>How is leasing the solar device different from borrowing money from a third party to buy the solar device?</u>

    When a taxpayer purchases a solar energy device, the taxpayer has acquired title (or will acquire, title to or an equity in the property). All costs of repairs, maintenance, taxes, insurance, etc. are obligations of the purchaser. Additionally, in this case, the owner of the property claims all depreciation for the property.

    If the lease was structured as a **capital lease**, the taxpayer has acquired title (or will acquire, title to or an equity in the property). All costs of repairs, maintenance, taxes, insurance, etc. are obligations of the purchaser. Additionally, in this case, the owner of the property claims all depreciation for the property.

    If the lease was structured as an **operating lease**, the taxpayer would not own the solar property. The third party (lessor) is the party that owns the solar property. All costs of repairs, maintenance, taxes, insurance, etc. are obligations of the lessor. Additionally, in this case, the owner of the solar property (the lessor) claims all depreciation for the solar property. However, if the lease was for commercial solar property, the lessee, when computing its federal income, would deduct the lease payments as an operating cost.

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John A. Greene, Director

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Date

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not

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adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.

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