BRACEWELL

BLOG POST

Legislation Affecting Energy Credits and FIRPTA Rules

January 8, 2016

By: **Elizabeth L. McGinley**

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act (the "Act"), which included, among other provisions, extensions of certain renewable energy tax credits and changes to the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA").

Tax Credits With Respect to Certain Renewable Resources

The renewable electricity production credit (the "PTC") was available under Section 45 of the Internal Revenue Code ("Code") for electricity produced at qualified renewable energy facilities from certain qualified energy resources (i.e., wind, closed-loop biomass, open-loop biomass, geothermal or solar energy, landfill gas, trash, qualified hydropower, and marine and hydrokinetic renewable energy), if the construction of such facilities began before January 1, 2015. The Act retroactively extends eligibility for the PTC for two years, providing that the PTC will be available for electricity produced at the types of facilities listed above, if the construction of such facilities begins before January 1, 2017. Additionally, pre-Act law permitted an election to forgo the PTC with respect to a qualifying facility, instead treating the facility as energy property eligible for the ITC, discussed below, at an energy percentage of 30%. The Act extends the ability to make such election if construction begins prior to January 1, 2017 (except for wind facilities, which were extended further subject to different rates).

For qualified wind facilities only, the Act extends eligibility for the PTC if the construction of the facilities begins before January 1, 2020. However, the PTC for wind facilities is gradually phased out if the construction begins after December 31, 2016 (the credit is also phased out in the same way in the case of a wind facility electing the ITC in lieu of the PTC). If construction begins in 2017, 80% of the PTC will be available, in 2018, 60% of the PTC will be available and in 2019, 40% of the PTC will be available. The PTC is phased out completely for wind facilities if construction begins after December 31, 2019.

Under pre-Act law, a business energy investment tax credit (the "ITC") was available under Section 48 of the Code for certain energy property (including e.g., equipment using solar energy, geothermal, qualified fuel cells or qualified microturbines, combined heat and power systems or equipment which uses the ground or groundwater as a thermal energy source) placed in service during the taxable year. The amount of the ITC was the energy percentage of the basis of energy property placed in service during the tax year. Under pre-Act law, the energy percentage for solar energy property was 30% for property placed in service through December 31, 2016 and generally 10% thereafter.

Under the Act, certain qualified solar energy property will continue to be eligible for the 30% ITC if construction begins before January 1, 2020. Eligible solar energy property includes equipment which 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. However, the Act gradually reduces the ITC available for solar projects the construction of which begins after December 31, 2019. The ITC will decrease to 26% for projects that begin construction in 2020, 22% for projects that begin construction in 2021, and thereafter, the energy credit will be 10%. Further, if qualifying solar energy property is not placed in service before January 1, 2024, it will only be eligible for the 10% credit, even if construction begins before January 1, 2022. The Act does not similarly extend the ITC for other types of renewable energy property (including e.g., geothermal, qualified fuel cells or qualified microturbines, combined heat and power systems or equipment which uses the ground or groundwater as a thermal energy source).

FIRPTA Amendments Increase Withholding Rates and Expand Permissible Foreign Ownership of Publicly Traded REITs

The Act also amends the FIRPTA rules. Under pre-Act law, Code Section 1445 generally required withholding on dispositions of United States Real Property Interests (“USRPIs”) at a rate of 10% of the gross proceeds of the sale. The Act generally increases the rate of withholding on dispositions of USRPIs to 15% of the gross proceeds of the sale.

Further, under pre-Act law, under the “cleansing rule,” a USRPI did not include any interest in a corporation if the corporation did not hold any U.S. real estate at the time of disposition of the interest, and all of the U.S. real estate held by such corporation during the applicable period (the shorter of (i) the period of time after June 18, 1980, during which the taxpayer held such interest, or (ii) the five-year period ending on the date of disposition of such interest), was either disposed of in transactions in which gain, if any, was fully recognized, or ceased to be USRPIs by reason of the application of the cleansing rule to one or more other corporations. Under the Act, regulated investment companies (“RICs”) and REITs are excluded from the cleansing rule and thus, the cleansing rule will only apply to a corporation that is not a RIC or a REIT.

Additionally, the Act excludes from FIRPTA tax and withholding any USPRIs held by certain qualified foreign retirement or pension funds (or entities owned by such retirement or pension funds).

Furthermore, under pre-Act law, distributions from a REIT to a foreign shareholder are generally subject to a look-through rule that treats such distributions as the sale or exchange of USRPIs by the foreign shareholder, taxable under FIRPTA as income effectively connected with a U.S. trade or business, to the extent the distributions are attributable to gain from the sale or exchange of USRPIs. Under pre-Act law, under the publicly traded exception, distributions on any publicly traded class of stock of a REIT were not subject to the above look-through rule and such distributions were not taxed under FIRPTA unless the foreign shareholder owned more than 5% of the REIT’s publicly traded class of stock.

The Act expands the publicly traded exception, providing that foreign shareholders of a publicly traded REIT will not be subject to the look-through rule on distributions, and will not be subject to FIRPTA tax as if they had sold or exchanged USRPIs, unless the foreign shareholder owned more than 10%, rather than 5% under pre-Act law, of the REIT’s publicly traded class of stock. The Act also makes several other changes affecting REITs.

If you would like to discuss the Act and its potential impact, please contact one of the following members of Bracewell & Giuliani's tax team:

Elizabeth McGinley (Partner) – ***elizabeth.mcginley@bgllp.com*** or +1.212.508.6173

Vivian Ouyang (Senior Counsel) – ***vivian.ouyang@bgllp.com*** or +1.212.508.6406

Curtis Beaulieu (Senior Counsel) – ***curtis.beaulieu@bgllp.com*** or +1.202.828.5806

Anne Holth (Associate) – ***anne.holth@bgllp.com*** or +1.212.508.6157