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IRS Public Letter Rulings Conflicted On Solar Tax Credits

Provisions state that some aspects of a solar power system must be allocated to structural functions under Section 48.

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On Oct. 31, the U.S. Internal Revenue Service (IRS) released Private Letter Ruling (PLR) 201444025, which was addressed to a manufacturer of solar systems that are mounted on real estate. The nature of the real estate, along with many other interesting facts, was redacted from the version of the ruling that was released to the public.

The ruling is a reminder that, with respect to the solar power systems, only "equipment that uses solar energy to generate electricity and includes storage devices, power conditioning equipment, transfer equipment, and parts related to those items" are eligible for the investment tax credit (ITC) provided for under Section 48 of the Internal Revenue Code.

Here's how the PLR described the solar system made by the manufacturer:

"Every component required to produce solar energy is attached to or housed in a [redacted text]. These [redacted text] are custom designed and are built specifically for the purposes of the solar energy systems. They come in varying heights, specific to the solar access needs of each location. ... The broad bases house the major system operational components, including wiring, conversion equipment, control equipment and energy storage batteries. These customized bases prevent the [redacted text], some of which have solar collection panels attached to the top, from blowing over in inclement weather. The bases also include special locking doors, both for security and so that the solar energy-producing equipment can be readily maintained."


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The PLR went on to add that the parts that are not specifically related to solar energy "are not suitable to be used for purposes other than supporting the solar electricity generation equipment. ... The cost to produce these [redacted text] is much greater than the cost to produce ordinary [redacted text]."

Further, the taxpayer only sells whole systems, so it is not possible to purchase the non-solar parts separately from the solar parts.

Letter of recommendation

In light of the language about the specialized nature of the equipment and the greater costs associated with the non-solar equipment, a reader of the PLR might have been tempted to think that the IRS was going to rule that all of the tax basis was eligible for the ITC. However, such readers were destined to be disappointed, because the IRS ruled that some portion of the tax basis must be allocated to non-solar functions.

With respect to the non-solar functions, the PLR concludes that some of the equipment that provides "structural support for solar collectors, may also provide structural support for lights, surveillance equipment, motion detectors, two-way transmission systems and other attachments not used for the generation of electricity from solar energy and will also protect the equipment from damaging weather and general degradation. [The] taxpayer should allocate some portion of the basis of [redacted text] (to the extent it performs another function) to non-energy property."

The PLR fails to answer a critical issue: What is the methodology for allocating the tax basis between ITC and non-ITC eligible functions? Thus, taxpayers and their advisors are left guessing with respect as to how to perform this allocation.

Three years earlier, the IRS reached a similar conclusion in PLR 201121005. That ruling says a roof-mounted solar power system "constitutes energy property under Section 48(a)(3) except to the extent that Treasury Regulation Section 1.48-9 requires a portion of the basis of the property is allocable to any portion of such property that performs a function of a roof, e.g., protection from rain, snow, wind, sun, hot or cold temperatures, or that provides structural support or insulation."

And, like its predecessor, the 2011 PLR did not provide any guidance as to how to perform that allocation.

Solar companies should note that, in this respect, the tax credit provided for in Section 25D for homeowners who install solar on their own homes is actually more accommodating than the credit provided for in Section 48 for investors in solar power systems.

Specifically, Section 25D(e)(2) provides that "no expenditure relating to a solar panel or other property installed as a roof (or portion thereof) shall fail to be treated as [tax credit eligible] solely because it constitutes a structural component of the structure on which it is installed."

If this language from Section 25D(e)(2) was in Section 48 or the regulations under it, these two PLRs would have had different holdings.

Thus, manufacturers of roof-mounted solar systems with significant parts that serve a non-solar function may want to consider recommending that their residential customers borrow - or pay cash - to acquire the system.

This way, the residential system owner can claim the tax credit under Section 25D. That credit may be larger than the tax credit under Section 48 after the allocation of tax basis to structural functions, as required by these PLRs.

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