Plugged In: Tax implications related to COVID-19

An overview of recent tax developments relevant to power and utilities, particularly organizations with renewable energy projects in the works

April 27, 2020

In this edition of KPMG Global Energy Institute's Plugged In, Rodney Anderson, Katherine Breaks and Julie Marion discuss renewable tax credit considerations due to the impact of COVID-19, and federal income tax provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

Solar projects had to "begin construction" prior to 2020 in order to take advantage of the full 30 percent investment tax credit (ITC) rate. Some taxpayers purchased equipment in 2019 to satisfy this requirement with the expectation that the equipment would be delivered in the first quarter of 2020. Due to delays associated with the coronavirus, some of that equipment may not be delivered on a timely basis. What should taxpayers be thinking about in this regard?

Under current law, one way taxpayers could qualify for the full 30% ITC rate was by incurring at least 5% of integral project costs prior to 2020 ("Safe Harbor"), typically by purchasing equipment or other project components. Cash method taxpayers generally incur equipment or other property costs when payment is made. Accrual method taxpayers (i.e., most large taxpayers) generally incur such costs only when the property is provided to the taxpayer. In general, property is treated as "provided" when the property is delivered or title is transferred (depending on the taxpayer's method of accounting).

Under a special rule, eligible accrual method taxpayers can treat costs for property as incurred when payment is made if they reasonably expect the property to be provided within three-and-a-half months from the date of payment (3½-month rule).

Many solar developers likely sought to take advantage of the 3 ½ month rule to satisfy the Safe Harbor by ordering and paying for equipment in late December, with the requirement that the equipment be delivered within 3½ months. However, due to the global pandemic, equipment manufacturers may have been unable to timely deliver the intended Safe Harbor equipment.

The 3½ month rule does not require delivery within 3½ months, but rather merely requires that the taxpayer have a reasonable expectation of delivery within that time frame. Thus, depending on the taxpayer's circumstances, supply chain delays may not have been apparent in late December 2019, and the taxpayer may have had a reasonable expectation that the property would be provided on a timely basis. In such cases, the Safe Harbor still may have been satisfied in 2019 provided the equipment is eventually delivered.

It is important to remember that, unless the IRS provides some relief, it is essential that the intended Safe Harbor equipment is eventually received. There is no relief for property that is not received because the vendor went into bankruptcy, voided the contract, or otherwise failed to deliver the property.

In order to be eligible for the full production tax credit (PTC) rate, wind projects that began construction in 2016 either need to be placed in service in 2020 or, based on the facts and circumstances, the taxpayer must demonstrate a continuous program of construction or continuous efforts toward completion of the project from the date that construction began until the project is placed in service (continuity requirements). What relief is available for wind developers that cannot complete construction by the end of 2020?

Applicable IRS guidance provides that if construction of a wind project is delayed due to certain "excusable disruptions," those disruptions will be ignored for purposes of determining whether the continuity requirements are satisfied.

A number of the excusable disruptions listed in the guidance may be relevant to the Coronavirus outbreak. Excusable disruptions include (i) natural disasters; (ii) delays at the written request of a federal, state, local, or Indian tribal government regarding matters of public safety, security, or similar concerns; (iii) delays in the manufacture of custom components; (iv) labor stoppages; (v) inability to obtain specialized equipment of limited availability; and (vi) supply shortages.

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NDP084587

Further, as the continuity requirements are purely administrative in nature, and are not set forth in the underlying statute, it is also possible that the IRS may issue some sort of blanket relief for wind projects that failed to reach completion by the end of 2020.

I am constructing a renewable energy project that will be placed in service in 2020, but now I am not sure whether I will owe sufficient federal income tax in 2020 to fully utilize the associated federal income tax credits. What are my options?

Renewable energy tax credits are general business credits (GBCs). There are limits on the amount of federal income tax liability that can be offset by GBCs. In general, the limit is $25,000 plus 75 percent of remaining federal income tax liability.

Unused credits can be carried back one year and forward 20 years. Thus, taxpayers that otherwise do not expect to owe federal income taxes in 2020 may be able to carry back any excess renewable energy credits from 2020 to offset their 2019 federal income tax liability and receive a refund of the prior year tax liability of their 2019 federal income taxes.

In this regard, taxpayers should be mindful of the interaction of this rule with the expanded net operating loss (NOL) carryback rules in the CARES Act.

In light of the economic slowdown, taxpayers may be looking for opportunities to manage cash flow, including refunds of prior federal income tax payments. Are there any provisions in the CARES Act that taxpayers should be aware of in this regard?

Yes, the CARES Act includes favorable provisions for both minimum tax credit (MTC) carryforwards arising prior to the Tax Cuts and Jobs Act (TCJA) and usage of net operating losses (NOLs). Under the Tax Cuts and Jobs Act (TCJA), the corporate alternative minimum tax (AMT) was repealed for tax years beginning after 2017. Minimum tax credit (MTC) carryforwards from prior years were eligible to be claimed against regular tax in any year after 2017, and any remaining MTCs could be refunded in accordance with the following schedule:

- In 2018, 50 percent of remaining MTCs were refundable;
- In 2019, 50 percent of remaining MTCs were refundable;
- In 2020, 50 percent of remaining MTCs were refundable; and
- In 2021, 100 percent of remaining MTCs were refundable.

For example, assume a taxpayer had no regular federal income tax liability for the period 2018–2021 and had $100x of MTCs. Under the TCJA, the taxpayer could claim $50x of refundable MTCs in 2018, $25x of refundable MTCs in 2019, $12.5x of refundable MTCs in 2020, and the balance of MTCs in 2021. Thus, under the prior law schedule, the taxpayer would not receive a full refund of its pre-2018 MTCs until it filed its 2021 tax return.

The CARES Act permits taxpayers to claim a full refund of MTCs in 2019, or, if they prefer, to file an amended 2018 return and claim any remaining amounts.

Also, under the TCJA, post-2017 NOLs could not be carried back, whereas pre-2018 NOLs could be carried back two years under prior law. The TCJA also limited the use of NOL carryforwards arising on or after January 1, 2018 to 80% of federal taxable income, whereas NOLs arising before 2018 were not subject to a similar limitation.

The CARES Act allows taxpayers to carryback NOLs from tax years beginning after 2017 and before 2021 for five years. The NOL is carried back to the first eligible tax year (i.e., 5 years) and then claimed against federal taxable income in the subsequent years. We are awaiting IRS guidance on which IRS form should be filed to claim the refund.

This provision allows taxpayers to offset pre-2018 ordinary income or capital gains that were taxed at rates of up to 35 percent, thereby generating a current refund and a favorable rate differential.

In addition, the CARES Act also temporarily suspends the 80% of taxable income limitation on the use of NOLs arising in tax years beginning before January 1, 2021, thereby permitting corporate taxpayers to use NOLs to fully offset taxable income in these years regardless of the year in which the NOL arose.

Taxpayers may also obtain permanent cash tax savings by filing accounting method changes for either 2019 or 2020 to accelerate deductions or defer revenue and increase the NOLs in those years.

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