

Summary of Specific Tax Extenders

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On December 18th, the president signed Public Law 114-113, which included extensions of multiple tax incentives which affect the equipment leasing and financing industry. These extensions include the retroactive application of several tax benefits, making some provisions permanent, as well as the unexpected extension and ultimate phase out in the future of several. The passage of this bill and the decisions made by the Congress in putting the various provisions into different categories of longevity has important implications for a future comprehensive tax reform effort, and is being viewed by many as laying a strong foundation for tax reform in the next Congress, which begins in January of 2017 after the presidential elections.

We have summarized some of the tax extensions and modifications which may be of interest to a number of ELFA members.

Bonus depreciation for property other than longer period production property, transportation property and certain aircraft

Bonus depreciation was extended retroactively to January 1, 2015 and prospectively through December 31, 2019, phasing out during those years. The schedule below is a summary of the effective dates and rates of the bonus depreciation based on the placed in service dates of new qualifying assets, except for certain property that is described as longer period production property, transportation property and for certain aircraft. So for the general assets commonly leased, including assets like trucks, machine tools, medical equipment, renewable energy systems and construction equipment, the bonus depreciation rules are fairly easy to follow. In summary, the bonus depreciation depends on the date the qualifying asset is placed in service and is as follows:

- I. 50% bonus depreciation for new property placed in service between 1/1/2015 and 12/31/2017
- II. 40% bonus depreciation for new property placed in service between 1/1/2018 and 12/31/2018
- III. 30% bonus depreciation for new property placed in service between 1/1/2019 and 12/31/2019

There are special bonus depreciation rules to facilitate sale-leasebacks and syndications. A sale-leaseback must occur within 3 months of when the lessee placed the property in service. A lease syndication must occur within three months of the original lessor placing the property in service.

Further, bonus depreciation is not subject to any haircut under the alternative minimum tax rules. In addition, there are modified rules for property placed in service between 1/1/2016 and 12/31/2019 which expands bonus depreciation to certain improvements to non-residential real property.

Bonus depreciation for longer period production property, transportation property and certain aircraft

The intent of the bonus depreciation rules is to enable companies to be able to plan their acquisitions knowing the tax aspects of the asset acquisition. With an asset that takes some months to construct, there are inevitably complicated questions. As such special rules pertain to those types of assets.

Longer period production property is property that (a) is acquired by the taxpayer or acquired pursuant to a written contract entered into before January 1, 2020 (or is built by the taxpayer and construction starts before that date), (b) is subject rules requiring capitalization, rather than expensing, of construction costs, (c) has a recovery period of at least 10-years or is transportation property used in the trade or business of transporting persons or property (commercial aircraft, ships and railcars), and (d) has a production period longer than a year and a cost of at least \$1 million.

This category of property with an extended placed in service deadline includes certain corporate aircraft that does not meet the preceding requirements but has the following characteristics (a) the cost exceeds \$200,000, (b) a production period longer than four months and (c) for which the purchaser made a nonrefundable deposit at least equal to the lesser of (i) 10% of the cost and (ii) \$100,000,

In the case of longer period production property and transportation property, each of the placed in service deadlines above is extended by a year. The bonus depreciation percentage used (i.e., 50%, 40%, or 30%) is based on the placed in service date (e.g., for property placed in service between 1/1/2020 and 12/31/2020, 30% is used; for property placed in service between 1/1/2019 and 12/31/2019, 40% is used; etc.). However, the cost of the project is bifurcated between the adjusted basis incurred prior to January 1, 2020 and those costs after January 1, 2020: the cost of such property incurred prior to January 1, 2020 qualifies for bonus depreciation as long as the property itself is placed in service by December 31, 2020; however, the cost incurred after December 31, 2019 will not be eligible for bonus depreciation.

Solar Energy Investment Tax Credit ("ITC")

The ITC was 30% and was not scheduled to decline to the permanent level until January 1, 2017, however, it too was amended. The previous in service date test for determining the ITC has been replaced with a "start of construction" test. Such test will presumably be consistent with the start of

construction standard published by the IRS for wind energy sector. Thus, the amount of the ITC is determined by the start of construction date as determined under the IRS's guidance, not the date the project actually commences operation. The new ITC percentages are:

- i. 30% for projects where construction started by 12/31/19,
- ii. 26% for projects where construction started between 1/1/20 and 12/31/20,
- iii. 22% for projects where construction started between 1/1/21 and 12/31/21, and
- iv. 10% for projects where construction started from 1/1/22 and thereafter

For those projects which are placed in service after 12/31/2023, the ITC drops to 10%. Thus, there is a point where a project must be completed, regardless of its start of construction date, in order to qualify for an ITC in excess of 10%.

Production Tax Credits ("PTC")

The PTC is an inflation-adjusted tax credit which is calculated by multiplying the specified annual published rate by the amount of renewable energy produced and sold from specified types of renewable energy projects (largely wind energy projects). The rate is determined annually by the U.S. Treasury based on a benchmark rate set in 2002 and adjusted by the inflation rate each year. The rate for wind is currently 2.3 cents per kilowatt hour of electricity generated and sold.

The credit is available to the producer of the energy for 10-years from the date the facility commences operations. The PTC had expired for new eligible renewable construction projects which had not commenced qualifying construction prior to December 31, 2014 but has now been extended retroactively for projects commencing construction January 1, 2015 through December 31, 2019. The qualification for PTC remains based on the start of construction as defined in the IRS's guidance. The PTC rate is adjusted based on the period that the construction commenced. The change in the rates and phase out of the PTC is as follows:

- i. PTC rate is 100% of the then current year PTC rate for projects where construction commenced between 1/1/2015 and 12/31/2016
- ii. PTC rate drops to 80% of the then current year rate for projects where construction commenced between 1/1/2017 and 12/31/2017
- iii. PTC rate drops to 60% of the then current year rate for projects where construction commenced between 1/1/2018 and 12/31/2018
- iv. PTC rate drops to 40% of the then current year rate for projects where construction commenced between 1/1/2019 and 12/31/2019

Example - For a project which commenced construction before December 31, 2016, it would receive a PTC based on the then current annual PTC rate published by the Treasury for its entire project term. For a project that commenced in 2017 then, that project would be eligible to receive only 80% of the then current rate for each of the next 10 years. Additionally, if the project has not commenced construction by December 31, 2019, it would no longer be eligible for PTC.

Energy Investment Tax Credit (“ITC”) in lieu of Production Tax Credits

Owners of wind farms and certain other types of renewable energy projects may elect to claim an ITC in lieu of claiming PTCs. Generally, smaller, and often less efficient, projects chose this credit because of its upfront value compared to the uncertainty of earning PTCs based on the actual production over a 10-year period. Previously, the producer could chose to claim a 30% ITC upon the in service date of the facility instead of the PTC over the 10-year period. Since the PTC is being phased out, this election is similarly being phased out using the same basic rules and percentage reductions, albeit applied to the 30% base ITC previously permitted.

Again the credit is based on the start of construction date and the continuous construction rules apply. The credit is generally claimed when the project is placed in service, although a qualified renewable energy project producer may elect to claim the credit during construction; however those rules are more involved and will not be addressed herein. In summary, the amount of the credit that may be claimed is as follows:

- i. ITC rate is 30% for projects where construction has commenced between 1/1/2015 and 12/31/16
- ii. ITC rate drops to 24% for projects where construction has commenced between 1/1/2017 and 12/31/2017
- iii. ITC rate drops to 18% for projects where construction has commenced between 1/1/2018 and 12/31/2018
- iv. ITC rate drops to 12% for projects where construction has commenced between 1/1/2019 and 12/31/2019

Example - A \$100 million project that commenced construction in 2017 and was completed in 2019, the project owner may claim an ITC of \$24 million in 2019.

Enhanced Code Section 179 expensing

Section 179 is similar to 100% bonus depreciation for specified value of new asset additions and taken as an election by the taxpayer. A taxpayer may elect to deduct the amount up to the Section 179 expensing limit, now set at \$500,000 with a \$2 million overall investment limit. For every dollar of new asset additions above the \$2 million overall investment limit, the amount of Section 179 expensing limit is reduced. Thus if an entity acquired \$2 million of new depreciable assets, it could expense \$500,000 immediately and the balance would be depreciated following the applicable depreciation rules. However if the entity acquired \$2.250 million, the Section 179 expensing is limited to \$250,000 (\$2,250,000 - \$2,000,000). As most leasing companies purchase more than \$2.5 million in assets in a year, Section 179 is inapplicable to many ELFA members who lease equipment, but is available to a significant proportion of ELFA Member companies' customers.

Active Financing Exception Made Permanent

PATH made permanent the active financing exception (AFE). AFE is typically used by U.S. headquartered multi-national banks and finance companies to defer U.S. tax on certain leasing and lending income earned outside the United States until the cash from that income is distributed to the U.S. parent. One of the requirements to qualify for this exception is to have employees operating the finance business in the foreign country in which the income is earned; however, there are host of other technical requirements.

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