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September 12, 2018

Letter Ruling No. 2018-01

[Redacted Text]
[Redacted Text]
[Redacted Text]
[Redacted Text], Hawaii **[Redacted Text]**

Re: Commercial Renewable Energy Technology Systems Installed and Placed in Service as Applied to **[Redacted Text]**.

Dear **[Redacted Text]**:

This responds to your letter dated March **[Redacted Text]**, 2018 (the "Ruling Request"), wherein **[Redacted Text]** ("Taxpayer") requested confirmation regarding application of the Renewable Energy Technologies Income Tax Credit ("RETITC") under section 235-12.5, Hawaii Revised Statutes ("HRS"), as further discussed below.

QUESTION PRESENTED

Whether a commercial solar energy system has been installed and placed in service for the purposes of the RETITC.

FACTS REPRESENTED BY TAXPAYER

Taxpayer is a **[Redacted Text]** corporation operating a **[Redacted Text]** whose Federal Employer Identification Number is **[Redacted Text]**.

Taxpayer contracted with an installer to build a solar energy system to provide energy for **[Redacted Text]**. The contract was executed on **[Redacted Text]**. Taxpayer's contract with the installer states that "Final Completion" of all work will be achieved after Taxpayer receives notice from the installer that the work has been completed and has accepted the solar energy system.

The solar energy system was briefly turned on for testing in December 2017. There is no formal written documentation regarding the test, but it was described as "successful." During preliminary discussions with a **[Redacted Text]** electrical inspector, Taxpayer was advised that **[Redacted Text]** required fencing to be built around outdoor electrical property, and that the inspector would not sign off until a fence was installed to surround the solar energy system. Taxpayer does not remember the exact date of the inspector's refusal but asserts that it was in

"late December 2017."

The installation of the fence was completed on January **[Redacted Text]**, 2018. All **[Redacted Text]** building and electrical permits were completed and approved by April **[Redacted Text]**, 2018.

LAW AND ANALYSIS

The RETITC "may be claimed for every eligible renewable energy technology system that is installed and placed in service in the State by a taxpayer during the taxable year." § 235-12.5(a), HRS. "'Renewable energy technology system' means a new system that captures and converts a renewable source of energy, such as solar or wind energy, into a usable source of thermal or mechanical energy, electricity, or fuel." § 235-12.5(c), HRS. The Hawaii Administrative Rules ("HAR") provide in pertinent part that, "'[i]nstalled and placed in service' means that the system is ready and available for its specific use." § 18-235-12.5-01(a)(3), HAR.

"An asset is placed in service when it is 'first placed in a condition or state of readiness and availability for a specifically assigned function.'" Visser v. C.I.R., 19 F.3d 32 (9th Cir. 1994) (citing 26 C.F.R. § at 1.167(a)-11(e)(1)(i)). "Generally, use of an asset during construction does not satisfy the placed in service requirement. The asset is considered placed in service when available for full operation on a regular basis." Id. (citing Noell v. Commissioner, 66 T.C. 718, 729 (1976)). Merely testing the system during construction does not satisfy the "placed in service" requirement. Noell, 66 T.C. at 729.

Typically, the government's approval and grant of a permit to operate a renewable energy technology system indicates that the system has been placed in service and is ready and available for full operation. However, in special circumstances where some facts are unclear, or the Taxpayer does not have all the relevant information regarding the permitting process, the Department will apply a five-factor test to determine whether a renewable energy technology system has been installed and placed in service for purposes of the RETITC. The following five factors, as articulated in Sealy Power, Ltd. V. C.I.R., 46 F.3d 382, 394-95 (5th Cir. 1995), must be analyzed: 1) whether the necessary permits and licenses for operation have been obtained; 2) whether critical preoperational testing has been completed; 3) whether the taxpayer has control of the facility; 4) whether the unit has been synchronized with the transmission grid; and 5) whether daily or regular operation has begun. Id. at 395. "[N]either the presence nor absence of any one of the . . . factors is dispositive of the 'placed in service' determination." Id. at 396. Thus, the Department will examine all five factors to determine whether the type of renewable energy technology system described in this letter ruling has been installed and placed in service.

First, with respect to whether the necessary permits and licenses for operation have been obtained, Taxpayer's building and electrical permits were completed and approved on April **[Redacted Text]**, 2018. In order for the solar energy system to be ready for its specific use or in a state of readiness, it must be compliant with all applicable laws including the electrical and building codes. Here, the solar energy system is a photovoltaic system intended to provide energy for Taxpayer's **[Redacted Text]** and is installed **[Redacted Text]**. As such, the solar energy system must be compliant with building and electrical codes **[Redacted Text]**. These codes require a fence to be built around this type of solar energy system. Taxpayers installed a fence around the solar energy system on January **[Redacted Text]**, 2018. This first factor strongly indicates that the system should be considered "placed in service" in 2018, because that is when it became compliant with all applicable laws and deemed fit for use by the relevant authorities.

Second, with respect to whether critical preoperational testing has been completed, Taxpayer stated that the "system was briefly turned on in December 2017 to test its operational function and capacity. There is no formal written documentation regarding this test." It is unclear whether any subsequent testing was done in 2018, so this factor suggests that the system could be considered placed into service during 2017. However, as discussed above, merely testing the system during construction does not satisfy the "placed in service" requirement. Noell, 66 T.C. at 729.

Third, with respect to whether Taxpayer has control over the system, the standard articulated in Sealy is whether Taxpayer demonstrates "the indicia of physical and legal control of the electric generating facility" in a particular year. 46 F.3d at 396. Although Taxpayer had physical control of the system after construction was completed in December 2017, the indicia of physical and legal control were significantly enhanced in 2018 with the installation of fencing and the approval of all required permits.

Fourth, with respect to synchronization with the transmission grid, Sealy instructs that "[s]ynchronization of an electric generating facility refers to the stage at which alternating current systems, generating units, or a combination thereof are connected and operate at the same frequency so that the voltages between the systems remain constant." 46 F.3d at 396. This sort of specialized determination goes beyond the Department's expertise. However, according to the facts presented by Taxpayer, there is only one system and it "will not be connected to the electrical grid," as the system is intended to provide energy for Taxpayer's **[Redacted Text]**. Thus, this factor can be disregarded in this particular case as it does not appear to apply to Taxpayer's situation.

Fifth, with respect to regular operation of the system, it is unclear from the facts presented by Taxpayer whether regular or daily operation of the system has actually begun. However, given that all necessary permits were not completed and approved until April **[Redacted Text]**, 2018, regular operation of the system for its intended purpose could not legally have begun in 2017. Thus, this factor indicates that the system was placed in service in 2018.

When applied to the five factors previously discussed, the facts presented by Taxpayer strongly indicate that the solar energy system was placed in service in 2018 and not 2017. Although some testing of the system was done in December 2017, this factor is outweighed by the installation of the fence in 2018, the approval of all required permits for legal operation of the system in 2018, and the fact that regular operation of the system did not start in 2017.

CONCLUSION

Taxpayer's renewable energy technology system was installed and placed in service in 2018.

This ruling is applicable only to Taxpayer and shall not be applied retroactively. It may not be used or cited as precedent by any other taxpayer. The conclusions reached in this letter are based on our understanding of the facts that you have represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusions in this letter will be modified accordingly.

Except for the specific ruling above, we express or imply no opinion concerning the tax consequences of the facts of this case under any other provision. The Taxpayers have reviewed a

redacted version of this ruling and agreed that it will be available for public inspection.

If you have any questions regarding this matter, please feel free to contact me at **[Redacted Text]**. Additional information on Hawaii's taxes is available at the Department's website at tax.hawaii.gov.

Sincerely,

Joshua J. Michaels
Administrative Rules Specialist