



**August 15, 2013**

Arizona Corporation Commission  
Docket Control  
1200 W. Washington St  
Phoenix, AZ 85007

**Re: Public Comment Letter of The Alliance for Solar Choice re Application of Arizona Public Service Company for Approval of Net Metering Cost Shift Solutions, Docket No. E-01345A-13-0248**

Dear Commissioners,

The Alliance for Solar Choice (“TASC”) respectfully submits this letter to present the attached legal memorandum from Skadden, Arps, Slate, Meagher & Flom LLP (“Memorandum”), addressing the tax consequences of the Application of Arizona Public Service Company (“APS”) for Approval of Net Metering (“NEM”) Cost Shift Solutions (“Application”). As discussed in TASC’s Protest to the Application (“Protest”), APS offers the Commission a choice of two poisons, the first of which would require residential customers to deliver all output from on-site electric generation to the utility.

The Memorandum confirms that such a requirement will essentially exchange federal tax credits for federal taxes, reversing the existing flow of money into Arizona. The APS proposal will jeopardize Arizonan’s access to the federal residential tax credit. Moreover, payments received by an APS customer under the APS proposal will likely increase the customer’s taxable gross income.

TASC will enter the Memorandum into the record of the proceeding at an appropriate time. At this time, we respectfully submit this public comment letter as a means of sharing important information with the Commission and the parties to this proceeding.

Sincerely,

Anne Smart  
Executive Director  
The Alliance for Solar Choice  
45 Fremont Street, 32<sup>nd</sup> Floor  
San Francisco, CA 94105

Enclosure: Memorandum re U.S. Federal Income Tax Consequences for Residential Solar Feed-In Tariffs

M E M O R A N D U M

August 9, 2013

TO: The Alliance For Solar Choice (TASC)

FROM: Sean Shimamoto, Partner, Skadden, Arps, Slate, Meagher & Flom LLP  
Emily Lam, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

RE: U.S. Federal Income Tax Consequences for Residential Solar  
Feed-In Tariffs

This memorandum summarizes certain U.S. federal income tax consequences regarding feed-in tariffs, value of solar tariffs, and other comparable in front of the meter solar configurations. Specifically, this memorandum will address (i) whether a residential solar system that would otherwise qualify for the Residential Energy Efficient Property credit under Section 25D<sup>1</sup> would so qualify under a feed-in tariff, and (ii) whether payments received by a taxpayer pursuant to a feed-in tariff constitute gross income of such taxpayer.<sup>2</sup>

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**Internal Revenue Service Circular 230 requires us to advise you that, unless otherwise expressly indicated, any U.S. federal tax advice contained in the analysis set forth below was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any tax-related matters addressed herein.**

**Background**

Several states, municipalities, and investor-owned utilities have enacted various forms of feed-in tariff arrangements or Value of Solar Tariffs (collectively, "FITs") for

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<sup>1</sup> Unless otherwise indicated, all Section references herein are to the Internal Revenue Code of 1986, as amended (the "Code").

<sup>2</sup> This memorandum analyzes the general framework of feed-in tariffs, value of solar tariffs, and other in front of the meter configurations under current law. The precise rules governing these configurations vary by program, which differences could change the U.S. federal income tax consequences discussed herein. However, the following analysis is generally applicable to all buy all/sell all arrangements as described further below in the "Background" section.

residential solar systems. These programs generally work as follows: utilities purchase all of the electricity generated by a residential solar system either under a long term power purchase contract or a tariff that changes values based on regulatory reviews. The homeowner sells all of the electricity generated by the residential solar system in exchange for a kWh rate. Legal title to the electricity passes prior to any ability of the homeowner to consume the electricity. The arrangement is thus a "sell all" situation in which the full amount of electricity generated by the residential solar system is sold to the utility.

In a separate transaction, the utility sells electricity to the homeowner for the homeowner's personal consumption. FITs are commonly referred to as "in front of the meter" transactions. Although FITs may differ in their specific terms, the above description provides the common framework of all FITs contemplated in the following analysis.

## **Discussion**

### *Section 25D Credit*

Individual taxpayers may be eligible for a tax incentive under Section 25D known as the Residential Energy Efficient Property credit (the "Section 25D credit"), for expenditures for qualified energy efficient residential property, which includes qualified solar electric property ("QSEP").<sup>3</sup> For expenditures on QSEP during the tax year, taxpayers are allowed a personal tax credit in the amount of 30% of such expenditure.<sup>4</sup> A QSEP expenditure is an expenditure for property that uses solar energy to generate electricity "*for use in a dwelling unit.*"<sup>5</sup> The dwelling unit must be located in the U.S. and must be used as a residence by the taxpayer.<sup>6</sup> Moreover, if less than 80% of the use of the property is for nonbusiness purposes in the dwelling unit,<sup>7</sup> only that portion of the expenditures which is properly allocable to use for nonbusiness purposes shall be taken into account.<sup>8</sup>

Because under FITs all of the electricity generated by the residential solar system is sold to the utility, that electricity is not used by the taxpayer/homeowner in its personal residence as expressly required to qualify for the Section 25D credit.

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<sup>3</sup> Section 25D(a).

<sup>4</sup> Section 25D(a)(1).

<sup>5</sup> Section 25D(d)(2) (emphasis added). *See also* Section 3.03 of Notice 2009-41, 2009-19 I.R.B. 933, released on May 11, 2009, by the Internal Revenue Service (a taxpayer claiming a Section 25D credit with respect to an expenditure is responsible for determining whether the expenditure appropriately relates to a qualifying dwelling unit).

<sup>6</sup> Section 25D(d)(2).

<sup>7</sup> A nonbusiness use in a dwelling unit would not include, for example, use for a home office. Treas. Reg. § 1.23-3(g).

<sup>8</sup> Section 25D(e)(7).

Further, as noted above, if the taxpayer is not directly using at least 80% of the electricity generated by the solar electric property for nonbusiness purposes, then the Section 25D credit is not available for that portion of business use. Under FITs, 100% of the electricity generated is sold to the utility, and thus 100% of the use of the residential solar system is for business use. Therefore, even if a residential solar system were otherwise eligible for a Section 25D credit, because all of the electricity generated is sold, none of it is used by the taxpayer for nonbusiness purposes, and thus none of the expenditures qualify for the Section 25D credit.

### *Gross Income*

In addition to the loss of the Section 25D credit, the payments received by a taxpayer for the sale of electricity under FITs appear to fall squarely within the definition of taxable gross income. Section 61 provides that gross income means "all income from whatever source derived." In the landmark case *Commissioner v. Glenshaw Glass*, the United States Supreme Court interpreted the concept of gross income broadly, "in recognition of the intention of Congress to tax all gains except those specifically exempted," to include "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."<sup>9</sup>

The terms of FITs provide for the sale by the taxpayer to the utility of all electricity generated by the taxpayer's residential solar system. In exchange, the utility compensates the taxpayer with either cash or a credit on the taxpayer's utility bill. Although the taxpayer may also purchase electricity from the utility, under FITs, the two transactions are separate and distinct. The proceeds from the taxpayer's sale of electricity to the utility therefore likely constitute gross income.

This conclusion is supported by Senate bill S.1225, introduced by Sen. Mark Udall, on June 26, 2013, which would add a new Section 139E to the Code to provide an income exclusion for "any gain from the sale or exchange to the electrical grid" of electricity generated by property with respect to which QSEP expenditures are eligible for a Section 25D credit, "but only to the extent such gain does not exceed the value of the electricity used at such residence during such taxable year." The proposed bill creates a clear negative inference that absent the income exclusion proposed in a new Section 139E, gain from the sale of electricity in this context constitutes gross income.

### **Conclusion**

Under current law, residential FITs jeopardize the Section 25D credit because electricity generated by such residential solar systems is sold to the utility, rather than used in a personal residence of the taxpayer. Further, payments received by a taxpayer under FITs are likely includable in taxable gross income.

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<sup>9</sup> 348 U.S. 426, 431 (1955).

## CERTIFICATE OF SERVICE

I hereby certify I have this day sent via overnight mail an original and thirteen copies of the foregoing document on this 15<sup>th</sup> day of August, 2013 with:

Docket Control  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, Arizona 85007

I hereby certify that I have this day served the foregoing documents on all parties of record in Docket No. E-01345A-13-0248 by delivering a copy thereof in person, or by mailing a copy thereof, properly addressed with first class postage prepaid to:

Arizona Corporation Commission	Janice Alward	1200 W. Washington St. Phoenix, Arizona 85007
Arizona Corporation Commission	Steve Olea	1200 W. Washington St. Phoenix, Arizona 85007
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Dated this 15<sup>th</sup> day of August, 2013, in San Francisco, California.

By 

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