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## GENERAL MEMORANDUM 13-030

### Internal Revenue Service Rules that a Tribe that Owns Renewable Energy Assets May Pass the Investment Tax Credits to its Lessee

On March 8, 2013, the Internal Revenue Service (IRS) released a private letter ruling addressing the question of whether an Indian tribe, as the owner of renewable energy property, may pass through investment tax credits to a lessee. The IRS concluded that, under the facts as presented, the investment tax credits can be passed to the lessee.

Federal law authorizes tax credits for investments in certain kinds of renewable energy facilities. In providing these tax credits, federal policy encourages private investments in renewable energy. Tax credits, however, have not been very effective in encouraging investments in renewable energy in Indian country. Tribes that seek to pursue renewable energy development may want to own the facilities that are developed, or at least to have a share of ownership through a joint venture. Given that Indian tribes are not taxable entities, tax credits are of no benefit to a tribe, unless, that is, the tax credit can be passed to a business partner that is a taxable entity. In the recent private letter ruling, the IRS expressed approval of one such arrangement.

The transaction described in the private letter ruling concerns the investment tax credit (ITC) under section 48 of the Internal Revenue Code (Code). 26 U.S.C. § 48. The ITC allows a taxpayer to take a tax credit for a portion of the cost of investment in "energy property," a term that includes several solar energy technologies (thermal, electric, and lighting), geothermal equipment, fuel cells, combined heat and power systems, small wind energy systems, and ground-source or groundwater-source heat pump systems. The private letter ruling does not address the production tax credit (PTC) (authorized by Code § 45), which provides a tax credit for utility-scale wind, geothermal, and biomass systems based on the amount of electric power delivered.

As described in the private letter ruling, the tribe plans to place into service a number of renewable energy assets, each of which is assumed to qualify as "energy property" under section 48. The tribe would be the owner of the renewable energy assets, which would be leased to lessee, who would operate the assets to generate electricity to be sold to third-party utilities and for use by the tribe in its governmental activities. During the lease term, lessee would be entitled to the net revenue from operation of the assets. On expiration of the lease term, the tribe would take over the assets and operate them directly.

The analysis by IRS includes a determination that, under the relevant statutory and regulatory provisions, the tribe and its lessee can both be considered the original users of the energy property. In determining whether the tax credit can be passed to the tribe's lessee, the IRS considered the implications of section 50 of the Code, which provides that the ITC is not available with respect to energy property used by a tax exempt organization or a "governmental unit" (i.e., the United States, a state or political subdivision, or an agency or instrumentality of the United States or a state). The IRS concluded that a tribe is not an organization that has been granted tax-exempt status; rather, Indian tribes are simply not subject to federal income tax statutes. This was established in a Revenue Ruling issued by the IRS in 1967.

As to whether a tribe is a "governmental unit" for purposes of section 50 of the Code, the IRS concluded that it is not. This conclusion rests, in part, on consideration of the Indian Tribal Governmental Tax Status Act (Code § 7871), which provides that a tribe is to be considered a state for certain purposes. Finding that section 7871 does not include section 50 as a code section for which a tribe is to be considered a state, IRS concludes that a tribe is not a "governmental unit" for purposes of section 50. Having found that section 50 does not render the tax credits unavailable, the IRS concluded that it is permissible for the tribe to pass them to its lessee.

It is important to note that a private letter ruling only applies to the specific taxpayer who requested the ruling and that it does not establish a precedent. Nevertheless, this is an important development in Indian Country as it suggests a way for tribes to utilize tax credits to attract investors for renewable energy projects. However, until the IRS issues a public Revenue Ruling or Procedure, a tribe considering a similar project may want to request its own private letter ruling from the IRS.

If we may be of further assistance regarding renewable energy tax credits, please contact us at the information below.

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